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IN THE

Supreme Court of the United States

October Term, 1960

COMMONWEALTH OIL REFINING COMPANY, INC.,

Petitioner,

—against—

THE LUMMUS COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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September 29, 1960

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—against—

THE LUMMUS COMPANY,

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner prays that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the First Circuit (Woodbury, Chief Judge, and Hartigan and Aldrich, Circuit Judges) entered June 16, 1960, vacating three orders of the United States District Court for the District of Puerto Rico which (a) temporarily enjoined respondent from prosecuting in the United States District Court for the Southern District of New York its petition to compel arbitration under two contracts between the parties

(R. 304-313*); (b) denied a motion of respondent to modify the said preliminary injunction (R. 327-336); and (c) stayed—until the District Court for the District of Puerto Rico determined whether valid and existing arbitration agreements existed and whether arbitration should be permanently stayed—the arbitration sought to be initiated in New York by respondent, and enjoined respondent both from prosecuting its petition in the United States District Court for the Southern District of New York to compel arbitration and from taking any steps in pursuance or furtherance of the arbitration for a like period (R. 331-346).

Citations to Opinions Below

The opinion of the district court (Magruder, C.J.) on the motion granting the first preliminary injunction is reported at 174 F. Supp. 485, and is printed in the certified transcript (R. 314-319). The opinion-order (Ruiz Nazario, D.J.) denying the motion to modify the injunction is reported at 175 F. Supp. 873, and is printed in the certified transcript (R. 327-330). No opinion was written in the District Court on the granting of the order for stay of arbitration and injunction of further proceedings in the New York court and

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* References are to pages of the certified transcript of the Record (Rule 21, sd. 3).

The pages of the first volume of the certified transcript, the appendix in the court below to the brief of the defendant-appellant, here the respondent, are numbered regularly; the pages of the second volume of the certified transcript, the appendix in the court below to the brief of plaintiff-respondent, here the petitioner, are identified by the suffix letter "a"; and the pages of the third volume, the proceedings in the Court of Appeals, are identified by the suffix letter "b".

References herein to the opinions of the Court of Appeals are to page numbers of Appendix B, *infra*.

in the arbitration; the order (Ruiz Nazario, D.J.), including findings of fact and conclusions of law, is printed in the certified transcript (R. 331-346).

The opinions of the Court of Appeals of the First Circuit have not yet been reported; they are printed, *infra* pp. 37-69, 70-74, and in the certified transcript (R. 7b, 89b).

Jurisdiction

The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1). The judgments of the Court of Appeals were entered on June 16, 1960 (R. 36b-37b). A petition for rehearing, duly filed by the petitioner on July 11, 1960 (R. 38b-88b), was denied on August 10, 1960 (R. 89b-93b).

Questions Presented

1. Whether in a diversity case a court of appeals has not rendered a decision directly in conflict with *Bernhardt v. Polygraphic Company of America*, 350 U. S. 198 (1956), where (a) a district court has applied the law of the forum as required by the *Bernhardt* case in deciding that there should be a plenary judicial trial whether alleged contracts containing arbitration clauses had been induced by fraud invalidating the arbitration provisions, and (b) the court of appeals reverses and holds that the governing law is that of the *different* place where the contract was made and that under such law petitioner was not entitled to a judicial trial of the fraud question and, while so substantially affecting the enforcement of rights given by the forum, the court of appeals fails to consider the Conflict of Laws rules of the forum respecting the law applicable

to compelling arbitration, fails to consider or give effect to the district court's decision that the law of the forum applies and the district court's application of that law, and fails to remand the case to the district court for further consideration of the Conflict of Laws question.

2. Whether a court of appeals exceeded its appellate function and the established limits of appellate discretion when, without finding any abuse of discretion by the court below or reversing any finding of fact of that court, it (a) reverses an interlocutory order of a district court staying an arbitration, directing a plenary trial of the issue of the arbitrability of the disputes involved and meanwhile enjoining a later proceeding in another district court to compel arbitration, and (b) disposes of the issue of arbitrability on the merits by applying different legal principles than those applied by the district court and making new findings of fact on matters on which the district court had made no findings.

3. Whether, where a court of appeals applies legal principles which require evidence of the ultimate merits of a claim not required by the principles of decision applied by a district court and reverses an interlocutory injunctive decision of a district court on the ground that the record does not affirmatively contain evidence responsive to the principles it has on appeal held to be controlling, the court of appeals must not either remand the case to the district court for further proof or accept the tender of such proof on a petition for rehearing.

4. Whether, where a court of appeals decides that a district court has not abused its discretion in enjoining the prosecution of later-commenced proceedings in another court to compel arbitration, pending the district court's determination by trial of the issues of arbitrability, it is not error for the court of appeals, when it reverses on the ground that the arbitration agreements are not on the facts rescindable, to instruct the district court to stay its own proceedings and remit the entire supervision of the matter of arbitration to the courts of the State in which the motion to compel arbitration is pending, particularly when the effect of such transfer of supervision is materially to affect the scope of the judicial review of any award that might ultimately be made in arbitration.

Statutes Involved

The statutory provisions directly involved are §§ 1 and 4 of the Arbitration Law of Puerto Rico, 32 L.P.R.A. §§ 3201 and 3204. The text of these provisions is printed, *infra* pages 30-32. Also involved are §§ 1448, 1450 and 1458 of the New York Civil Practice Act, the relevant parts of which are printed *infra* pages 32-36.

Statement of the Case

Petitioner, a Puerto Rican corporation (R. 7) "contracted" with respondent, a Delaware corporation with its principal office in New York City (R. 7), on July 8, 1954 for the design, construction and initial operating supervision and guaranteed performance and operability of an oil refinery at Guayanilla, Puerto Rico at a guaranteed maxi-

mum cost of $19,000,000 (R. 8, 155) and, on March 14, 1956, for the design, construction, initial operating supervision and guaranteed performance of a proposed second oil refinery (or expansion refinery), to be adjacent to the first, at a guaranteed maximum cost of $15,985,400 (R. 9, 155). Each "contract" contained the following clause (R. 162):

> "25.1 Any controversy or claim arising out of or relating to this Agreement shall be settled by arbitration in accordance with the rules, then obtaining, of the American Arbitration Association. This Agreement shall be enforceable and judgment upon any award rendered by all or a majority of the arbitrators may be entered in any court having jurisdiction. The arbitration shall be held in New York, U. S. A. It is agreed, however, that this Agreement shall not apply to claims or damages for which either party has contracts of insurance protecting their respective interests.
>
> * * * * *"

Construction of the original refinery was substantially complete at the end of 1955 and crude oil was charged into its process units in January 1956 (R. 193); the expansion refinery was substantially complete in September 1957 and crude oil was first charged to it on about September 30, 1957 (R. 193-194). Neither the original nor the expanded refinery ever operated at design through-put on any day from January 1956, when the original refinery was started up, through December 31, 1958, 15 months after the expansion refinery was started up (R. 57-58, 93a-96a, 210a-215a). The refinery had many operating difficulties (R. 194). There was an early abortive demand for acceptance tests (R. 194), but respondent did not formally demand that pe-

titioner conduct acceptance tests until November 11, 1958 (R. 197), nearly two years and ten months after the original refinery was substantially complete and over thirteen months after the expansion refinery was substantially complete.

Petitioner has paid respondent $32,480,526 for the original and expansion refineries; in addition petitioner has had to expend $10,600,000 on a construction program to correct, improve and enlarge the refinery to place it in an economically operable condition (R. 60, 124-145). Petitioner has long refused to pay the $4,597,997.85 that respondent claims is due, publicly and repeatedly asserting that respondent owes petitioner more on its counterclaims than respondent claims for its work (R. 42, 198).

Basic to the refinery project and to its financing had been the calculation of the quantities and proportions of finished products that could be extracted from available crude oils and the cost of the refinery equipment necessary so to produce such finished products (R. 26, 97a-100a). Respondent furnished these calculations to petitioner and petitioner relied upon them in "contracting" with respondent to build the original and expansion refinery (R. 27, 51, 200-205; *cf.* R. 28-31, 34-37; see, *e.g.*, R. 64-82, 132a-138a, 185a-192a; for their use in connection with the financing of petitioner, see R. 54-55, 139a-145a, 203-205).

The falsity of the representations (R. 45, 310, 340), as petitioner's proofs tendered in the Court of Appeals showed (R. 49b-88b), was not discovered by petitioner until March 1959 and, in essence, turned on the undisclosed substitution of a highly experimental design of equipment for a commercially proven design (*cf.* R. 193a-195a, 297) a substitution of design evidently made to compensate for a serious, and

undisclosed, error in the product yield calculations respondent had supplied to petitioner (R. 66b-68b; also 50b-51b, 87b-88b; compare with R. 134a-138a, R. 164).

As indicated, the plant has never operated as represented. Petitioner, instead of realizing over $4,000,000 a year of net income on the original refinery and over $11,000,000 a year on the original and expansion refineries combined, as represented by respondent's pre-contract calculations of the crude input, product yields and refinery costs, has sustained over $14,000,000 of operating losses in the three years 1956 through 1958 (R. 58-59).

On April 29, 1959, respondent mailed petitioner a demand for arbitration in New York of the pending controversies (R. 17, 156). Petitioner promptly on May 4, 1959 sued respondent in the United States District Court for the District of Puerto Rico for damages and for such rescission of the contracts under the laws of the State of New York as was equitable or a declaration of the inexistence of the contracts under the laws of Puerto Rico, alleging fraud in the inducement of contracts (R. 7-11, 157). Simultaneously petitioner moved under Section 4(4) of the Arbitration Laws of Puerto Rico, 32 L.P.R.A. § 3204(4), for an order staying the arbitration demanded by respondent and restraining respondent from taking any steps in furtherance of arbitration (R. 13-18, 157).

Over two weeks later respondent petitioned the New York Supreme Court, County of New York, for an order to compel petitioner to arbitrate (R. 152-158); petitioner removed the proceeding to the United States District Court for the Southern District of New York (R. 324). Respondent then vainly sought to have all judicial proceedings in Puerto Rico enjoined by the United States District Court for the

Southern District of New York until that court finally decided the New York petition to compel arbitration (R. 275-284, particularly R. 276, 10a-11a). Meanwhile, petitioner applied *ex parte* in the Puerto Rican District Court for an order, which was granted, restraining any further prosecution by respondent of its New York proceeding (R. 17-21).

On June 1, 1959 the court in Puerto Rico heard petitioner's motion to stay the arbitration, its oral motion to extend the *ex parte* restraining order, and its additional motion, presented at the hearing, to enjoin further proceedings in the New York case or in the arbitration until the motion to stay arbitration, made in the Puerto Rican court on May 4, 1959, could be finally determined (R. 232a-233a; R. 287-288). The hearing embraced also respondent's motions to deny petitioner a stay of arbitration, to vacate an order permitting the taking of depositions, to vacate the *ex parte* restraining order, to extend respondent's time to plead, and to stay all proceedings until further order of the court (R. 146-147; R. 232a-233a). At the conclusion of the hearing the court extended the *ex parte* restraining order for a second period of ten days (R. 233a; R. 285-286). Thereafter, a further hearing was held on June 5, 1959 in the Puerto Rican District Court on petitioner's motion for preliminary injunction against further proceedings in New York or in the arbitration (R. 300).

The District Judge in Puerto Rico, however, had not decided the motions to stay arbitration and for preliminary injunction when the extended restraining order expired on June 18, 1959, and he was moreover outside Puerto Rico in attendance at the Judicial Conference of the Circuit (R. 303). Accordingly, at the suggestion of Magruder, C. J.,

retired, sitting by assignment, petitioner again moved for a preliminary injunction of any further proceedings in New York until the pending motions in Puerto Rico could be decided (R. 299-302; R. 315). The motion was heard and granted by Judge Magruder and is the first of the orders respondent appealed to the Court of Appeals (R. 304-313; R. 347). Respondent's motion to have that injunction modified to the extent of permitting it to move to remand the New York case to the District Court (R. 325-326) was denied (R. 327-330), giving rise to the second order appealed from (R. 348).

The District Court of Puerto Rico then determined the principal pending motions. By its order it (a) stayed the arbitration until it determined whether there were valid and existing arbitration agreements; (b) fixed respondent's time to answer the Puerto Rican complaint and indicated the course to be followed in arranging for a plenary trial of the issues respecting fraudulent inducement of the contracts; and (c) enjoined respondent from taking further proceedings in the New York court or in arbitration until the District Court of Puerto Rico finally determined whether there were existing and valid arbitration agreements (R. 331-346). Respondent's third appeal was from this order (R. 349).

The Court of Appeals reversed (R. 36b-37b). It held that the District Court had not abused its discretion in entertaining the motions to stay arbitration and to enjoin the later-commenced New York proceedings (41-42). It decided that the preliminary findings of the court below that petitioner had made out a *prima facie* case of fraudulent representations, justifiable reliance thereon, and

fraudulent (or reckless) intent were not reversible (49-50). However, notwithstanding that the District Court had decided that Puerto Rican law applied (48; see R. 343), the Court of Appeals decided that the applicable law was the law of New York which governed the contract as such (53-54). Under New York law, and the law generally, it held, petitioner's suit did not really seek to rescind the entirety of the "contracts" involved but only their arbitration clauses (59-63). It held, moreover, that petitioner had not shown, in excuse of its apparently late assertion of fraud and of a right to rescind, that it had only recently discovered the fraud complained of and therefore could not rescind (63-66). The Court of Appeals on these grounds reversed and advised the District Court to stay its own proceedings pending arbitration and to dismiss its proceedings if all issues were disposed of by arbitration or otherwise (68-69).

Petitioner applied for a rehearing (R. 39b-88b). The Court of Appeals rejected petitioner's contention that the Court's decision dealt prematurely and incorrectly with an issue going to ultimate relief and appropriate only to a full trial of the case stating that it had, rather, decided that petitioner was not "really pursuing a restitutionary remedy . . . but . . . damages while rescinding the arbitration agreement alone" (71).

The Court of Appeals had also rested its decision on the legal principle that petitioner had to anticipate by affirmative evidence possible defenses of laches and ratification (63-67) in order to establish the existence of a substantial dispute as to the validity and existence of any agreements to arbitrate which would entitle it to a plenary

trial of the dispute (66-67). The Court of Appeals had ruled against petitioner not on the ground that there was in fact laches or a ratification but on the ground that the record evidence did not affirmatively disprove it (65-66). The District Court had applied no such legal principle or standard of proof and had made no finding on the point; it ordered a plenary trial in which any such affirmative defense would have had to be supported by evidence tendered by respondent (R. 339-340, 342-343, 345).

Petitioner on rehearing, therefore, tendered affidavits showing the very recent discovery of the evidence of fraud, and thus explanatory of the apparently late assertion of the claim of fraud (R. 49b-88b). The Court of Appeals stated that having "devoted a sizable portion of the past several months to the complexities of this unusually difficult case", it had no desire to consider a new record at the present stage if not shown that it had erred on the record before it, and justified this procedure by saying petitioner had not earlier claimed that the issue was not ripe for decision* (72).

Thus the Court of Appeals foreclosed the issue on the merits, and with finality without according petitioner a hearing on facts that first became relevant when, diffring from the District Court, the Court of Appeals adopted a legal principle that called for facts not in the record.

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* The point was not posed on the original briefs in a manner that justified this comment of the Court of Appeals. The argument of petitioner was that the belatedness of its claim depended on the date of discovery and petitioner pointed out *inter alia* that the evidence relied on as "ratification" signified that the date of discovery followed the last of such "evidences". The argument assumed, as did the District Court, that *respondent* would have to prove ratification by acts of affirmation occurring *after* discovery.

The Court of Appeals advised further that the stay of its own proceedings to be entered in the District Court was based on the belief that there should be no further duplication of litigation in two Federal courts of concurrent jurisdiction, that there was no reason for the court below to remain as the court that would supervise whatever arbitration was to occur and that the New York court should supervise the arbitration (73-74).

Reasons for Granting the Writ

1. The Court of Appeals has decided important Federal questions in a way in conflict with applicable decisions of this Court.

(a) *Bernhardt* v. *Polygraphic Company of America*, 350 U. S. 198 (1956), requires that where the question of arbitrability comes up in a Federal court sitting outside the State where the contract to arbitrate was made, the Federal court must decide it in the manner in which the State courts of that forum would decide it upon applying their own law, including their rules of the Conflict of Laws. The rule of the case recognizes that the remedy by arbitration substantially affects causes of action created by the States and that the change from a court of law to an arbitration panel may make a radical difference in ultimate result. While the Court of Appeals, here, cited the *Bernhardt* case (53), the court invoked and applied the law of the place of the making of the alleged contracts (53-54). It ignored both the District Court's express adoption of the law of the forum (R. 343) and the District Court's determination, made in the language of Sec-

tion 4 of the Arbitration Law of Puerto Rico (32 L.P.R.A. § 3204), that a substantial dispute had arisen as regards the validity and existence of the arbitration agreements by reason of the existence of a substantial dispute as to whether the contracts had been induced by fraud that would nullify the contracts and consequently the arbitration clauses they contained (R. 343).

The Court of Appeals departed from the principles of the *Bernhardt* case point for point. In the present case, as in the *Bernhardt* case, the "contracts" were made in New York; in the *Bernhardt* case, additionally, both parties were New Yorkers at the time of contracting. In both cases the contract provided for arbitration in New York. In both cases the question whether arbitration could be compelled arose in a court other than the courts of New York. In the *Bernhardt* case this Court held that the law of the forum was the governing law; in this case the Court of Appeals held that the law of the place of contracting was controlling (53-54). In the *Bernhardt* case this Court gave special weight to the local judge's statement of the local law of arbitration (350 U. S. at pages 204-205). In the present case, the Court of Appeals ignored the determination of the local judge that the local arbitration law applied and ignored his determination of the questions arising under that local law. This Court, in the *Bernhardt* case, pointed out that it was not clear that the District Court had considered as a Conflict of Laws question the rival claims of the laws of New York and Vermont to control the question of arbitrability and indicated that that point would be open for consideration on remand to the District Court. In the present case, the

Court of Appeals rejected the explicit holding of the District Court that the Puerto Rican arbitration law applied and rejected that court's interpretation of the local law. The Court of Appeals instead made its own direct application of the law of the place of the making of the contract (53-54).

The Court's disregard of the *Bernhardt* case led it further into the gravely prejudicial decision entirely to supplant the District Court of Puerto Rico in the arbitration phases of the case on the ground that New York law governed (68-69, 73-74) and that supervision of the arbitration should be transferred to the courts of New York (74). Under the *Bernhardt* case the Court's decision would effect a total change in applicable law; the Puerto Rican court was bound, by *Klaxon Co.* v. *Stentor Co.*, 313 U. S. 487 (1941), to apply Puerto Rican law, including its Conflict of Laws rules, to the issue of arbitrability; the New York court will be bound by the same case hereafter to apply its own law, including its Conflict of Laws rules, to the same issues of arbitrability.

The two arbitration laws differ in a very material respect, that is, in respect of the grounds on which an arbitration award may be reversed. Under Section 22(c) of the Arbitration Law of Puerto Rico (32 L.P.R.A. § 3222(c)) an award may be reversed for error in excluding relevant and material evidence or for any other error impairing the rights of any of the parties. The New York Law of Arbitration admits of reversal of an award for rejection of pertinent and material evidence only if the rejection constitutes misconduct rather than error; only misconduct, not mere error, prejudicial to the rights of any party makes

an award reversible (New York Civil Practice Act
sd. 3; *Matter of Wilkins*, 169 N. Y. 494, 496 (1902);
of S & W Fine Foods, Inc. v. *Office Employees Interna*
Union, 8 A. D. 2d 130 (1st Dept. 1959), aff'd 7 N.
1018 (1960); *Matter of Goff & Sons* v. *Rheinauer*, 199
Div. 617 (1st Dept. 1922); *Matter of Wagner* v. *Ru*
Fifth Avenue, Inc., 281 App. Div. 825 (1st Dept. 1
Matter of Nadalen Mills v. *Barbizon Corp.*, 206 Misc
(1954)).

The conflict of the decision of the Court of Appeals
this Court's decision in the *Bernhardt* case is not reli
by the intimation in the Court of Appeals that the c
below might well have deferred initially to the New Y
court (42-43, 73). The Court of Appeals considered t
question and concluded, as it had to conclude, that the Pu
to Rican court had not abused its discretion in taking ju
diction of the matter and proceeding to its decision (4

(b) The Court of Appeals, by ignoring the express fin
ing as to applicable law of the court below and its implic
interpretation of the local law that it found to be applicab
(R. 343), followed by the failure of the Court of Appea
at minimum to remand the case to the District Court for it
further consideration on the question of applicable law
proceeded in a manner in conflict with this Court's decisio
in *De Castro* v. *Board of Commissioners of San Juan*, 32
U. S. 451 (1944). See *Nadal* v. *May*, 233 U. S. 447, 45
(1914). The *De Castro* and *Nadal* cases require the Court
of Appeals to accord deference, on appeals from local tri-
bunals, to their understanding of matters of local concern
and they extend that requirement as well to appeals from

the Federal courts sitting in territories as to appeals from the territorial courts. See also, *Diaz* v. *Gonzalez*, 261 U. S. 102 (1923), *Bonet* v. *Yabucoa Sugar Co.*, 306 U. S. 505, 307 U. S. 613 (1939), *Bonet* v. *Texas Company (P.R.) Inc.*, 308 U. S. 463 (1940). The principle is cognate to, but stronger than, the principle specifically adverted to in the *Bernhardt* case (350 U. S. at pp. 204-205), that special weight should be given to statements on local law made by Federal judges of the locality. See *MacGregor* v. *State Mutual Co.*, 315 U. S. 280 (1942), *Hillsborough* v. *Cromwell*, 326 U. S. 620, 630 (1946), *Steele* v. *General Mills*, 329 U. S. 433, 439 (1947).

(c) The Court of Appeals in committing the supervision of arbitration to the New York courts and denying further supervisory authority to the Puerto Rican court in substance misapplied this court's decision in *Kerotest Mfg. Co.* v. *C-O-Two Fire Equip. Co.*, 342 U. S. 180 (1952). The court below concluded that the Puerto Rican court was in fact the first court to take hold of the cause and that there was no abuse of discretion in proceeding. It recognized also that priority of pendency is often taken as a basic factor in determining which of two concurrent proceedings should give way. The court, moreover, found no error either in the legal tests applied by the Puerto Rican court nor in the factual decision of the Puerto Rican court in this regard. Nevertheless, it instructed the court below to stay its own proceedings (68-69) and remit entirely to the New York court the supervision of the arbitration proceeding (73-74) evidently relying solely on the intimation (73) in its main opinion that the Puerto Rican court, in preserving its own priority of jurisdiction, had employed a "rigid, mechanical solution" frowned upon by the *Kerotest* case (42).

But the *Kerotest* case locates in the District Court the judicial discretion to solve questions concerning which of two suits should proceed; the Court of Appeals may interfere only where there has been an abuse of discretion by the District Court (342 U. S. at pages 184-185). The Court of Appeals, here, did not mention or review the facts relevant to testing the Puerto Rican court's discretionary determination (reciting the considerations advanced by respondent only to say that they would not be considered) (41-42); rather, it affirmatively found that there was no abuse of discretion (42-43). It recognized further that disposition of all issues through proceedings in the New York court and in arbitration was only a possibility and not certain to make it unnecessary ultimately to pursue the Puerto Rican action that it stated should be stayed (69). Nevertheless, the Court of Appeals instructed the District Court of Puerto Rico to stay its proceedings and remit all matters respecting supervision of arbitration to the New York court (68-69, 73-74). The effect is not to cure but to invite multiple litigation.

The action of the Court of Appeals in superseding the decision of the District Court on a point of discretionary jurisdiction which concededly involved no abuse of judicial discretion was in plain conflict with this Court's decision in the *Kerotest* case.

(d) The Court of Appeals made very plain its preference for the questioned view, adopted in *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2nd Cir. 1959), certiorari granted 362 U. S. 909 (1960)*, that if no specific

*The *Lawrence* case, it is believed, has been settled since the grant of certiorari.

misrepresentation has induced the inclusion of an arbitration clause in a contract, the mere fact that the contract as a whole was induced by a fraud should not invalidate the arbitration clause (51-53, 54-56; also 71). With manifest reluctance the court confessed itself "constrained to accept as an established doctrine of New York law that an arbitration clause cannot be treated as separable from the other parts of the contract" (56). Yet the court arrived at a severability result by proceeding on the assumption that the New York decisions trended at least in the direction "of a more careful consideration of what is sought when the party opposing arbitration cries fraud" (58). On this basis and upon a misreading of the complaint, never urged by respondent at any stage of the case, the court concluded that petitioner was not seeking such a rescission as would bring it within the New York rule because it was not tendering by its complaint or argument a restoration of what it had received under the contracts (59-63; see also 71). In essence the court thus held that an acknowledged principle of New York law yielded to the court's preferred rule of the severability of arbitration clauses except where a specific type of rescission was sought by a party complaining of fraud in the inducement of an entire contract.*

(e) The decision of the Court of Appeals has thus disposed of important Federal questions in a way conflicting with applicable decisions of this Court. It has misapplied

*The questions presented by the petition for certiorari in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 362 U. S. 909 (1960), would have raised this point as a matter of the Federal substantive law of arbitration, if any such law there be. See particularly the second of the three questions presented by the petition. The writ of certiorari was granted without limitation.

the *Bernhardt* case, ignored the *De Castro* and *Nadal* cases and departed from the standard of appellate review established by the *Kerotest* case.

2. The Court of Appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

The decision of the District Court of Puerto Rico was factual, discretionary and based on a view of the Puerto Rican law that required petitioner to show only a *prima facie* case of fraud and did not require petitioner to anticipate affirmative defenses of laches and ratification (R. 339-340, 342-343, 345). The District Court found as a fact that petitioner had shown a *prima facie* case of fraud in the inducement that required resolution by a plenary judicial trial of the issues to be framed by the complainant and respondent's answer (R. 343). The District Court, amid the recognized "complexities of this unusually difficult case" (72), did not finally resolve any issue of law or fact against either party. It decided only that it would determine the issue of fraud through a plenary trial and meanwhile preserve its jurisdiction from the threat of multiple litigation (R. 340, 343, 345-346).

The Court of Appeals determined that the court below had *not* abused its discretion in so proceeding and had not erred in determining that a *prima facie* case of fraud had been made out (43, 49-50). The Court of Appeals, however, held, as a mixed question of pleading, law and fact, and on the basis of a different view of the controlling legal principles, that petitioner had not sued for the right sort of rescission of the contracts (59-63) and had

failed affirmatively to establish that its claim was not barred by laches or by an affirmation of the contracts. (63-66). The Court of Appeals then concluded that the supposed error of the District Court in failing so to hold should not result in a remand for the taking of further proofs to meet the Court of Appeals' view of the applicable legal principles, in the continued exercise of the acknowledged jurisdiction of the District Court. Instead, the Court of Appeals itself summarily determined on the merits the issues of fact made relevant by its new view of the law. It rejected on rehearing tendered evidence that its summary conclusion, based on a void in the record, was incorrect in fact, and instructed the District Court entirely to stay its own proceedings and to surrender the supervision of whatever arbitration was to be had to the New York court (68-69, 73-74).

These dispositive determinations of the Court of Appeals invaded the fact-finding province and the discretion of the District Court and exceeded the appropriate limits of appellate review; in ousting the District Court of jurisdiction to supervise the arbitration, it rendered a decision repugnant to its own determination that no abuse of discretion existed in entertaining and proceeding in the case.

(a) The Court of Appeals decided, on the facts, that petitioner was guilty of laches (64-65) and had affirmed the contracts (65-66) because the record in the District Court did not affirmatively show when petitioner first learned of the fraud and yet petitioner had not asserted its claim of rescission for fraud until May 1959. On these facts the District Court had not passed or made any findings since obviously it considered, as a matter of law, that petitioner had only to show a *prima facie* fraud to be en-

titled to a trial on the merits and did not have to anticipate possible affirmative defenses (R. 339-340, 342-343, 345). The appellate court's different view of the law imposed on petitioner for the first time the burden of anticipating the possible defenses of laches and ratification. Yet when petitioner tendered the missing proofs needed to meet this change in legal theory, the proofs were not received and petitioner was forever precluded from making the factual proofs that first attained relevancy when the Court of Appeals formulated a view of the law different from the District Court's.

To reverse with finality in this manner and on this ground was to invade the fact-finding function and judicial discretion of the District Court. *Fountain* v. *Filson*, 336 U. S. 681 (1949); *Byrd* v. *Blue Ridge Cooperative*, 356 U. S. 525, 529-533 (1958); *cf. Globe Liquor Co.* v. *San Roman*, 332 U. S. 571, 573-574 (1948); *see United States* v. *Morgan*, 182 F. 2d 986 (D.C. Cir. 1950); *Elder* v. *Brannan*, 184 F. 2d 219 (D.C. Cir. 1950), *modified* 341 U. S. 277 (1951); *Helms* v. *Duckworth*, 249 F. 2d 482, 488 (D.C. Cir. 1957). The District Court had either deferred consideration of this issue to the plenary trial or had implicitly decided it oppositely to the manner in which the Court of Appeals decided it. Certainly the District Court acted will within its discretion if, as is plain from its order, it deferred this matter to the plenary trial (R. 339-340, 342-343, 345). Laches and election to affirm are matters of equitable defense as to which respondent had the burden of proof. See Rule 8(c), Fed. R. Civ. P.; *Tornello* v. *Deligiannis Brothers, Inc.*, 180 F. 2d 553 (7th Cir. 1950); *Bergeron* v. *Mansour*, 152 F. 2d 27 (1st Cir. 1945); *Thibodo* v. *United States*, 187 F. 2d 249, 257 (9th Cir. 1951), 134 F. Supp. 88, 98 (S.D. Cal. 1955); 3 Black, *Rescission and Cancellation*, §§ 614, 615, 679 (2d ed. 1929).

If, on the other hand, the District Court is taken to have decided that the record did not disclose such laches or such an election to affirm as would obviate the need for a plenary trial of these and the other issues, the Court of Appeals has pointed to no error in that determination but has instead taken the legal view that the record must not merely fail to disclose laches or ratification but must also affirmatively disprove it. But to take that view required the Court of Appeals either to remand for further proofs or itself to accept the proofs. Its function was exhausted with ruling that, as a matter of law, these issues required affirmative evidence and with remanding to take such evidence—except as it elected to receive such evidence as a means of supporting the order made below.

The one course not open to the Court of Appeals was the one it took, foreclosing the issue with finality knowing that the facts were the reverse of its own factual conclusion and knowing that its own legal theory alone, and not that of the court below, had made the facts relevant to a disposition of the case. *Fountain* v. *Filson*, 336 U. S. 681 (1949). The effect is to grant summary judgment against petitioner without reference to the merits and to preclude any reexamination of these issues of merit.

(b) The Court of Appeal's determination that petitioner had not *sought* rescission is replete with inferences and assumptions of fact that further demonstrate that the Court of Appeals improperly, summarily, and with finality performed *ab initio* the fact-finding function on a controversial record made at an interlocutory stage of the case and improperly superseded the discretionary function of the District Court. *Wiggins* v. *Gray*, 65 U. S. (24 How.) 303 (1860); *W. A. Mack Inc.* v. *General Motors Corporation*,

260 F. 2d 886, 890 (7th Cir. 1958); *Shearman* v. *Missouri Pacific R.R.*, 250 F. 2d 191, 194-5 (8th Cir. 1957); *Holzer* v. *United States*, 244 F. 2d 562, 564 (8th Cir. 1957); *Burton* v. *Matanuska* [illegible]*ey Lines, Inc.*, 244 F. 2d 647, 650-1, 653 (9th Cir. 1957); *Mytinger & Casselberry, Inc.* v. *Numanna Laboratories Corp.*, 215 F. 2d 382, 384-5 (7th Cir. 1954); *Hamilton Watch Co.* v. *Benrus Watch Co.*, 206 F. 2d 738, 740, 742-743 (2d Cir. 1953); *City of Des Moines* v. *Continental Illinois Nat. B. & T. Co.*, 205 F. 2d 729, 732-734 (8th Cir. 1953); *Benson Hotel Corporation* v. *Woods*, 168 F. 2d 694, 696-697 (8th Cir. 1948); *Love* v. *Atchison, T. & S. F. Ry. Co.*, 185 Fed. 321, 331, 333 (8th Cir. 1911), cert. den. sub nom.: *West* v. *Atchison T. & S. F.*, 220 U. S. 618 (1911); *cf. Wessel* v. *Seminole Phosphate Co.*, 13 F. 2d 999, 1004 (4th Cir. 1926); *United States* v. *Moroz*, 182 F. 2d 986, 989 (D.C. Cir. 1950); *Carr* v. *Corning*, 182 F. 2d 14, 22 (D.C. Cir. 1950); *Riley* v. *Titus*, 190 F. 2d 653, 656 (D.C. Cir. 1951), cert. den. 342 U. S. 855.

The Court of Appeals recognized that special damages are recoverable in connection with and in addition to rescission and restitution (60), that a tender-back of what has been received does not have to precede suit for rescission (62 and fn. 17), that restoration in money rather than in specie is permitted where specific restoration incident to rescission is impossible (62-63), and that, if restoration in specie becomes impossible before the party seeking rescission and restitution learns the facts and has an opportunity to act, restitution is granted upon the payment of value or the imposition of conditions if justice cannot otherwise be done (62-63). These views precluded the conclusion that petitioner could not be seeking rescission because it seemed to prefer to keep what it had received, recover special damages and compensate for what it had re-

ceived by an offset to respondent in *quantum meruit*. But the Court of Appeals nevertheless inferred as a fact that petitioner was seeking a "partial" rescission limited "presumably" to the provisions for arbitration simply and solely because petitioner seemingly "desired" to retain what it had received while seeking a decree of rescission (60, 63).

The inference was forced from the form of the prayer for relief, which, the court said, "seems" (60) to be a claim for damages for deceit "based upon an affirmance of "part of the contract, together with rescission of part of the contract" (60). Respondent at no time urged any such point. It read the complaint as seeking "to recover damages . . . and . . . rescission of said contracts under the laws of the State of New York and a declaration of the inexistence of said contracts under the laws of Puerto Rico" (R. 157); respondent described "the issues raised by [petitioner's] complaint" as being "whether or not the contracts can be rescinded" (R. 282); complaining that petitioner's claim was belated, respondent stated that "the filing of the complaint was the first time that [petitioner] had ever asserted that such contracts were in any way void or voidable or could be rescinded" (R. 199). The complaint did not have, to the respondent on whom it was served, "the appearance of a mere claim for partial rescission appended upon the damage action" (60).

The appellate court's inference that only a "partial" rescission was sought depended on the supposed absence of a clear-cut manifestation of willingness on petitioner's part to make such a restoration in specie as equity required. But admittedly equity might require no restoration in specie

whatever (62). The prayer for relief in rescission subjected petitioner to whatever orders respecting equitable restoration the trial court might make. Petitioner's supposed wish not to restore even that which it might not be able to restore, since it was coupled with its submission of its rights to equitable jurisdiction, was completely compatible with total rescission; petitioner prayed rescission on the terms it believed to be equitable (62-63). Petitioner was not, as the Court of Appeals held, required to express a preference for the extremest duty of restoration that any facts could require and to forego praying for the relief—well within the range of equitable discretion—that it conceived to be equitable.

The inference drawn by the Court of Appeals, erroneous on its face we submit, was a complex inference of intention based on the bare suspicion that "presumably it is . . . the provisions for arbitration" (60) alone that petitioner sought to rescind, and the court's "belief" that "where nothing else in the case suggests that rescission and restitution are necessary to afford [petitioner] compensation for its injury" (63), the supposed fact that petitioner was seeking only to avoid the arbitration clauses would not justify it in failing to offer restoration of the consideration received under the contracts (61-63). The Court of Appeals had no factual basis from which to draw this tangled and contorted factual inference.

The inference that rescission and restitution were unnecessary to afford Commonwealth the compensation for its injury that it sought is wrong. The contracts were not sale of goods contracts; they were complex service contracts. They contained test provisions, limitations of liability, and provisions for presumed acceptance which, if

not rescinded, could hamper and embarrass petitioner's claims (R. 155, 171-175, 194-198). The appellate court's controlling factual inference—that petitioner was seeking to stand on the contract, except for its arbitration clause, and retain all that it had received—is contradicted by the overwhelmingly more justifiable inference that, from the very nature of the contracts as essentially service contracts, rescission of the entire contracts could take no other form than a claim for special damages against which would be offset any compensatory relief to which respondent was entitled in equity and *not* as a matter of contract "right". The *prima facie* special damage recoverable by petitioner upon a rescission would be not less than the sum of the amount it paid to respondent, $32,480,526 (R. 9), the amounts expended in achieving corrections, improvements and enlargements, $10,600,000 (R. 60), and the operating losses suffered, $14,343,189 (R. 59). The offsetting compensation to respondent would be measured not in contract terms, since the contracts should be rescinded, but in terms of equitable evaluations of what, in money, petitioner should restore by way of offset.

The District Court had not considered or made any finding on this point. Hence the Court of Appeals was limited to determining the legal relevancy of the point and to remanding it for consideration on the facts. It was without power itself summarily to dispose of the point on its own findings of fact. *Cf. Sartor* v. *Arkansas Natural Gas Corp.*, 321 U. S. 620, 628-629 (1944); *Kennedy* v. *Silas Mason Co.*, 334 U. S. 249 (1948).

(c) The Court of Appeals determined that the District Court of Puerto Rico did not abuse its discretion in enter-

taining the issues raised by the complaint and the motions to stay arbitration and for injuction and in granting the interim relief it did grant (42-43). Nevertheless, having determined that the court below erred in finding as a fact that there was a substantial issue as to the making or the existence of the contracts (because it had not considered petitioner's supposed laches and affirmance), the Court of Appeals, instead of reversing and remanding for further proceedings in accordance with the appellate court's opinion and in continuing exercise of the District Court's jurisdiction, instructed the court below to stay its own proceedings (68-69), to discontinue its supervision of whatever arbitration was to be had and to remit the matter of supervising the arbitration to the court in New York (R. 92b). The Court of Appeals so decided notwithstanding that it recognized that proceedings in the New York court might not be dispositive of all issues pending in the Puerto Rican court (69) and that, by reason of the insurance exception, there might indeed be no arbitration at all to supervise (72-74).

In thus proceeding, the Court of Appeals rendered a decision repugnant to its own determination that the court below had and had properly exerted its jurisdiction (42-43). It plainly exceeded its appellate functions by intruding its own discretionary choice of the court of New York as the one to proceed when the District Court of Puerto Rico had already, and admittedly rightly, decided to accept, exert and preserve jurisdiction. As pointed out above (*supra*, pp. 15-16), the consequence of this intrusion of its discretion by the appellate court does not result merely in the choice of a forum more convenient for re-

spondent, but under *Bernhardt* v. *Polygraphic Company of America*, 350 U. S. 198 (1956), it works a momentous change in the applicable law governing review of any final arbitral award.

CONCLUSION

It is therefore respectfully prayed that this petition for a writ of certiorari be granted.

Respectfully submitted,

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September 29, 1960

APPENDIX A

Statutes Involved

Laws of Puerto Rico, Annotated, Title 32, Subtitle 4, Chapter 259, Sections 3201 and 3204:

"§ 3201. Arbitration agreements valid

Two or more parties may agree in writing to submit to arbitration, in conformity with the provisions of this chapter, any dispute which may be the object of an existing action between them at the time they agree to the arbitration; or they may include in a written agreement a provision for the settlement by arbitration of any dispute which may in future arise between them from such settlement or in connection therewith. Such an agreement shall be valid, requirable and irrevocable except for the grounds prescribed by law for the reversal of an agreement."

"§ 3204. Motion to compel arbitration

(1) Any of the parties to a written arbitration agreement who claims negligence or refusal on the part of another party to resort to arbitration according to the agreement, may move the court for an order compelling the parties to resort to arbitration in conformity with the agreement between them. An eight days' written notice of said petition shall be given to the party who it is alleged is not complying with the agreement. The return of said notice shall be made in the manner prescribed by law or by the Rules of Civil Procedure for the return of summonses in civil actions before the court, as specified in section 3202 of this title. If, after hearing both parties, the

court finds that no substantial dispute exists as regards the existence or validity of the arbitration agreement, or the nonperformance thereof, said court shall issue an order commanding the parties to resort to arbitration in conformity with the terms of the agreement.

(2) If the court finds that a substantial dispute has arisen as regards the validity or existence of the arbitration agreement, or as to nonperformance thereof, the court shall proceed immediately to hear such dispute. If from the hearing it is found that there is no written agreement providing for arbitration, or that there is no nonperformance, the court shall deny the motion to compel arbitration.

(3) Either party shall have the right to demand an immediate hearing of any dispute of this nature concerning the validity or existence of an arbitration agreement or the nonperformance thereof. Such a petition shall be made prior to the day set for the hearing of the motion to compel arbitration in conformity with this section; and if such motion is not filed, the request shall be made in the petition for staying the arbitration, as provided in the following paragraph 4(a).

(4) In order to give rise to a dispute concerning the existence or validity of an arbitration agreement or the nonperformance thereof, the party concerned shall state the proved facts on which said dispute is founded, and shall:

(a) File a motion to stay the arbitration. If notice has been served of the intent to arbitrate, as provided in section 3211 of this title, notice of the motion to

stay shall be served within the twenty days following the return of such notice of intent to arbitrate.

Any dispute concerning the validity or existence of the agreement or the nonperformance thereof, shall be tried in the same manner prescribed in subdivisions Nos. 2 and 3 of this section; or.

(b) Oppose any motion to compel arbitration, as provided in subdivision 1 of this section."

New York Civil Practice Act, Sections 1448, 1450 and 1458, in part:

"§ 1448. Validity of arbitration contracts or submissions. Except as otherwise prescribed in this section, two or more persons may submit to the arbitration of one or more arbitrators any controversy existing between them at the time of the submission, which may be the subject of an action, or they may contract to settle by arbitration a controversy thereafter arising between them and such submission or contract shall be valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract.

* * * * *

Such submission or contract may include questions arising out of valuations, appraisals or other controversies which may be collateral, incidental, precedent, subsequent to or independent of any issue between the parties."

"§ 1450. Remedy in case of default. The making of a contract or submission for arbitration described in section fourteen hundred forty-eight, providing for arbitration in this state, shall be deemed a consent of the parties thereto

to the jurisdiction of the supreme court of this state to enforce such contract or submission and to enter judgment on an award thereon. A party aggrieved by the failure, neglect or refusal of another to perform under a contract or submission providing for arbitration, described in such section may petition the supreme court, or a judge thereof, for an order directing that such arbitration proceed in the manner provided for in such contract or submission. Eight days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner specified in the contract or submission, and if no manner be specified therein, then in the manner provided by law for personal service of a summons, within or without the state, or substituted service of a summons, or upon satisfactory proof that the party aggrieved has been or will be unable with due diligence to make service in any of the foregoing manners, then such notice shall be served in such manner as the court or judge may direct. The court, or a judge thereof, shall hear the parties and upon being satisfied that there is no substantial issue as to the making of the contract or submission or the failure to comply therewith, the court, or the judge thereof, hearing such application, shall make an order directing the parties to proceed to arbitration in accordance with the terms of the contract or submission.

If evidentiary facts be set forth raising a substantial issue as to the making of the contract or submission or the failure to comply therewith, the court, or the judge thereof, shall proceed immediately to the trial thereof. If no jury trial be demanded by either party, the court, or the judge

thereof, shall hear and determine such issue. Where such an issue is raised, any party may, not later than five days after the service of the order directing a trial of such issue, demand a jury trial of such issue, and if such demand be made, the court, or the judge thereof, shall make an order referring the issue or issues to a jury in the manner provided by law for referring to a jury issues in an equity action. Whenever an immediate trial is ordered the order therefor shall provide that if the court, or where a jury has been demanded, the jury, find that a written contract providing for arbitration was made or a submission was entered into, as the case may be, and that there was a failure to comply therewith, the parties shall proceed with the arbitration in accordance with the terms of the contract or submission, and said order shall provide that if the court or jury, as the case may be, find that there was no such contract or submission or failure to comply therewith then the proceeding shall be dismissed.

The procedure herein provided shall be applicable to any motion made under this article in which an issue is raised as to the making of the contract or submission or the failure to comply therewith."

"§1458. Enforceability of award in certain cases. An award shall be valid and enforceable according to its terms and under the provisions of this article, without previous adjudication of the existence of a submission or contract to arbitrate, subject, nevertheless, to the provisions of this section:

* * * * *

2. A party who has not participated in the selection of the arbitrators or in any of the proceedings had before them and who has not made or been served with an application to compel arbitration under section fourteen hundred fifty may also put in issue the making of the contract or submission or the failure to comply therewith, either by a motion for a stay of the arbitration or in opposition to the confirmation of the award. If a notice shall have been personally served upon such party of an intention to conduct the arbitration pursuant to the provisions of a contract or submission specified in such notice, then the issues specified in this subdivision may be raised only by a motion for a stay of the arbitration, notice of which motion must be served within ten days after the service of the notice of intention to arbitrate. Such notice must state in substance that unless within ten days after its service, the party served therewith shall serve a notice of motion to stay the arbitration, he shall thereafter be barred from putting in issue the making of the contract or submission or the failure to comply therewith. The name and address of the party serving such notice of intention to arbitrate, or of an officer or agent thereof if the said party is an association or corporation, shall be endorsed on such notice. The notice of motion for a stay of the arbitration may be served upon the party, or upon the officer or agent thereof, either personally or by registered mail. The arbitration hearing shall be adjourned upon service of such notice of motion pending the determination of the motion. Where such opposing party, either on a motion for a stay or in opposition to the confirmation of an award, sets forth evidentiary facts rais-

ing a substantial issue as to the making of the contract or submission or the failure to comply therewith, an immediate trial of the same shall be had. In the event that such party is unsuccessful, he may, nevertheless, participate in the arbitration if the same is still being carried on. Any party may, not later than five days after the service of the order directing a trial of such issue, demand a jury trial of such issue."

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 5552.

THE LUMMUS COMPANY,
DEFENDANT, APPELLANT,

v.

COMMONWEALTH OIL REFINING COMPANY, INC.,
PLAINTIFF, APPELLEE.

No. 5553.

SAME *v.* SAME; and

No. 5554.

SAME *v.* SAME.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO.

Before WOODBURY, *Chief Judge*, and HARTIGAN and ALDRICH, *Circuit Judges*.

John T. Cahill, with whom *Lawrence J. McKay, Raymond L. Falls, Jr., Herbert S. McConnell, Putnam, Bell, Santry & Ray, Cahill, Gordon, Reindell & Ohl* and *McConnell, Valdes & Kelley*, were on brief, for appellant.

John F. Dooling, Jr., with whom *Richard deV. Manning, Milton Pollack, Hamilton F. Potter, Jr., Jeffrey A. Fillman, Ruben Rodriguez-Antongiorgi, Sullivan & Cromwell* and *Fiddler, Gonzalez, Guillemard & Rodriguez* were on brief for appellee.

OPINION OF THE COURT.

June 16, 1960.

ALDRICH, *Circuit Judge*. This is an appeal under 28 U.S.C. § 1292(a)(1) from an interlocutory order, dated July 20, 1959, of the United States District Court for the District

of Puerto Rico entering a preliminary stay of arbitration and granting a preliminary injunction enjoining defendant-appellant from taking any further action in a case pending in the United States District Court for the Southern District of New York, or any other steps in furtherance of the arbitration. Defendant-appellant, The Lummus Company, a Delaware corporation with its principal office in New York, N. Y., is engaged, *inter alia*, in designing and constructing oil refineries. Plaintiff-appellee, Commonwealth Oil Refining Co., Inc., is a Puerto Rican corporation, which describes itself as the owner of an oil refinery in Puerto Rico built for it by the defendant. The controversy between the parties arises out of two contracts entered into in New York in July 1954, and March 1956, under which Lummus undertook to design, build, initially supervise, and guarantee the performance of, first, the original refinery, and then later its expansion facilities, for a guaranteed maximum cost of some $35,000,000. Both contracts contain the following clause:

> "Any controversy or claim arising out of or relating to this Agreement shall be settled by arbitration. . . . The arbitration shall be held in New York, U.S.A."[1]

---

[1] The entire clause reads:

> "25.1 Any controversy or claim arising out of or relating to this Agreement shall be settled by arbitration in accordance with the rules, then obtaining, of the American Arbitration Association. This Agreement shall be enforceable and judgment upon any award rendered by all or a majority of the arbitrators may be entered in any court having jurisdiction. The arbitration shall be held in New York, U.S.A. It is agreed, however, that this Agreement shall not apply to claims or damages for which either party has contracts of insurance protecting their respective interests."

No issue has been raised with respect to the last sentence and we assume it has no applicability to the claims here involved.

Appendix B

The refinery has been built, and Lummus has received some $32,500,000 therefor. The original plant commenced operation on December 31, 1955, and the expansion facilities on September 30, 1957. Operation, however, has been at a marked loss, rather than at the substantial profit anticipated. Since at least 1957 Commonwealth has expressed dissatisfaction with Lummus' performance, and Lummus, *inter alia*, with Commonwealth's refusal to pay sums claimed to be due for work and materials.

On April 29, 1959, Lummus mailed, and on April 30 Commonwealth received, a demand for arbitration of its claim to recover some $4,700,000 from Commonwealth, and of "any set-offs or counterclaims . . . which Commonwealth may assert." On May 4, Commonwealth instituted an action in the District of Puerto Rico, in which it alleged, in substance, that Lummus had prepared "oil refinery economic and capability studies and earnings projections based thereon (herein called, collectively, 'studies and projections')" relating to the refinery; that the "'studies and projections' were false and misleading," and that Lummus either knew this to be so or made the representations "with reckless indifference as to the truth or falsity thereof"; that Commonwealth relied on the "studies and projections" and was induced by the representations contained therein to execute the two contracts, "which plaintiff would not have executed but for such false and misleading 'studies and projections' . . . "; and that, "by reason of the facts set forth in this complaint, plaintiff has suffered financial losses and damages in an amount exceeding $60,000,000 . . . ." As relief, the complaint sought:

"(a) judgment . . . in the sum of $60,000,000, plus other sums as yet undetermined . . . ; and

"(b) such rescission under the laws of the State of New York of the two contracts . . . as may be just and equitable . . . or a declaration as to their inexistence under the laws of the Commonwealth of Puerto Rico . . . ."[2] At the same time Commonwealth served a motion in the district court, "pursuant to 32 L.P.R.A. § 3204(4)(a),"[3] to stay the New York arbitration on the ground that the arbitration clauses were invalid by reason of fraudulent inducement of the contracts. On May 20 Lummus served a motion in the New York County Supreme Court to compel arbitration. On May 25 Commonwealth filed a petition to remove that proceeding to the United States District Court for the Southern District of New York, hereinafter called the Southern District. On May 29 Lummus obtained from that court an order for Commonwealth to show cause, returnable June 2, why the present proceedings should not be enjoined. No further steps were taken in the Southern District because on the same day Commonwealth obtained from the court below, *ex parte*, a temporary order restraining further proceedings in the Southern District. On June 1, Commonwealth moved for a preliminary injunction restraining Lummus from taking any further action in the Southern District or elsewhere in furtherance of arbitration until

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[2] We will analyze this complaint in more detail later. There is a further claim not material to the present proceedings, as no preliminary relief is requested thereunder, which will be disregarded.

[3] Chapter 259, §§3201-29, Title 32 L.P.R.A., constitutes the Puerto Rico Arbitration Act. Its provisions are typical of modern arbitration statutes. The provisions relevant here are discussed further *infra*.

final determination of the motion of May 4 for a stay of arbitration. Decision was reserved on this motion, but the temporary restraining order was continued in force to June 18. On that date, Judge Ruiz Nazario being out of the district, a hearing was held before Senior Judge Magruder, sitting in the district court by special assignment, on the matter of continuing the temporary restraining order pending determination by Judge Ruiz Nazario of the original motion to stay arbitration, and of the motion for a preliminary injunction. On June 19 Judge Magruder entered a preliminary injunction, to expire July 20, stating that he was doing so in order to give Judge Ruiz Nazario opportunity to make the final decision on the questions before him. See 174 F. Supp. 485. On July 6 Lummus moved for a modification of Judge Magruder's order to permit it to move in the Southern District to remand that action to the state court. This motion was denied on July 17. See 175 F. Supp. 873.[4] On July 20 Judge Ruiz Nazario entered an order preliminarily staying the arbitration "until this Court enters its order finally determining whether there are valid and existing arbitration agreements . . . ." and granted the preliminary injunction enjoining Lummus from taking any steps in furtherance of the arbitration, in the Southern District or otherwise.

Admittedly Lummus' appeal from the decree of July 20 presents all pertinent matters. It raises a substantial number of difficult questions. They can be divided into three major groupings. First, Lummus contends that the dis-

[4] Appeals from these orders of June 19 and July 17 are also before us. They will be separately considered.

trict court, as a matter of equitable jurisdiction, should not have enjoined the New York proceedings, but should rather have stayed its own. It bases this contention, first, on the priority of the New York proceedings, arguing that they commenced with the service of the arbitration demand, and second, on the contention that New York is a more proper forum because New York law is controlling, because New York is more convenient for the parties and witnesses, and because jurisdiction over Lummus in Puerto Rico is doubtful.[5] We do not stop to consider these contentions at any length. What we presently have here is simply a question of two pending actions, *i.e.*, the motion to stay arbitration and the action to compel arbitration, in two federal courts of concurrent jurisdiction, each of which is being asked to consider what is basically a different side of the same coin. There is no reason why both suits should continue at the same time. This would be detrimental to both the parties and the federal judicial system. Although priority of suit is often taken as a basic factor in determining which should give way, see *Martin v. Graybar Elec. Co.*, 7 Cir., 1959, 266 F. 2d 202, "wise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation, does not counsel rigid mechanical solution of such problems." *Kerotest Mfg. Co. v. C-O-Two Fire Equip. Co.*, 1952, 342 U. S. 180, 183. We are disposed to believe that the District Court in Puerto Rico was in fact the

[5] This last matter was argued to some extent below and the court preliminarily found that jurisdiction over the person of Lummus had been obtained. We concur in this preliminary finding, but the issue is not really before us on this appeal except in this tangential fashion.

first *court* to take hold of this matter. *Cf. Marchant* v *Mead-Morrison Mfg. Co.*, 2 Cir., 1928, 29 F. 2d 40, 42-43, *cert. den.*, 1929, 278 U. S. 655; *American Houses, Inc.* v. *Schneider*, 3 Cir., 1954, 211 F. 2d 881, 885; *Minkoff* v. *Scranton Frocks, Inc.*, D.C.S.D.N.Y., 1959, 172 F. Supp. 870, 876-77. We also believe that there were sufficient reasons which would have justified that court, as a matter of discretion, in staying its own proceedings in favor of those in New York. But as it has not done so, we are not prepared to hold that there was an abuse of discretion.

The second grouping of issues concerns the power of the district court. Lummus contends that a federal court sitting in Puerto Rico is unable to stay an arbitration which the parties have specified is to take place in New York. In the view we take of this case, this issue becomes moot. It also contends that the New York proceedings were improperly removed from the state court, and that had they remained there, 28 U.S.C. § 2283 admittedly would have prevented the court below from enjoining the proceedings in the state court. It assigns three reasons why the removal was improper. First, a motion to compel arbitration under a state statute involves a remedy which a federal court cannot grant; second, the removal was not timely because not made within twenty days after the service of the demand for arbitration; and third, the Southern District, as an Article III court, is without diversity jurisdiction because Commonwealth is a citizen of Puerto Rico, which is not a State within the meaning of Article III of the Constitution. Should we answer the first two contentions in favor of Commonwealth, we would be faced with the third, which raises constitutional issues.

Under familiar principles, these should not be decided unless necessary. We accordingly pass to the third grouping, which we find dispositive. This is that Commonwealth's allegations of fraudulent inducement present no substantial issue as to the voidability of the arbitration contracts which would warrant a plenary hearing.

All facts were established by affidavits and exhibits. Commonwealth was incorporated in May 1953. Since October 1951, however, Lummus had been working with those persons who were promoting and organizing the refinery. The organizers were engaged in securing contracts for the purchase of crude oil, commitments for the sale of refined products, financial backing, and, of course, designs and a contract for construction. Lummus assisted the organizers, and then the corporation itself, in their negotiations for purchase and sale contracts. It also supplied the corporation with economic and profitability estimates for many hypothetical refineries. Upon being told what type of crude oil would be used and what type of refined products were desired, Lummus would estimate the type of refinery needed, the capital outlay for such a refinery, and the expected profit. These estimates went through a number of revisions as different types of crudes or refined products were hypothesized. Essentially the same type of estimates were also made for the expansion facilities. Some of the figures concerning product yields supplied by Lummus were also used by the underwriters in charge of the financing in the preparation of profitability forecasts which were included in two volumes, known as the Green and White Books, used to interest prospective investors. The construction contracts with Lummus were negotiated over

a long period of time, and each had an effective date at least six months prior to the date of execution. The contracts guaranteed the maximum construction costs, and guaranteed product yields, both as to quantity and quality, but neither contained the type of profitability forecosts [sic] which Lummus had earlier furnished. Both contracts contained provisions for performance tests designed to establish whether or not the refineries met the contractual guarantees. For various reasons, including the fact that Commonwealth has not been processing the crude oils upon which the guaranteed yields were based, Lummus' demands for tests have not been met. This has been a major area of contention.

In May 1956, two months after making the contract for the expansion facilities, Commonwealth ceased making payments due to Lummus under the original contract, claiming setoffs. In October 1956, it informed Lummus that, "Recent reports appear to confirm our fears concerning possible basic inadequacies in design or construction." Commonwealth's Annual Report for 1956, dated January 31, 1957, indicates a number of the difficulties encountered in operations which resulted in a substantial loss instead of a contemplated profit. It stated that "our greatest difficulties have been with the vacuum tower, the catalytic cracker and the utilities, namely, power, steam and cooling water." It appears from the record that the irregular electric power supply was the fault of the Puerto Rico Water Resources Authority, but that the irregularities had caused considerable loss of operating time because of the use of highly sensitive control mechanisms which needed a more stable power source. In February 1957, there were

extensive changes in top management, and the executive offices were moved from New York to Puerto Rico. In May 1957, the M. W. Kellogg Co. was hired by the underwriters to make an independent evaluation of the refinery. The report, dated November 25, 1957, as of October 23, 1957, pinpointed four major factors accounting for an "uneconomic operating history." These were: 1. unreliable electric power; 2. electronic instrumentation incompatible with the power supply; 3. circulation difficulties in the catalytic cracking unit; and 4. "an overly integrated heat exchange system . . . ." (This latter had also been pointed out to Commonwealth by another independent study submitted in January 1956.) The report indicated that steps had already been taken to correct some of these deficiencies and that upon completion of other planned capital expenditures, the refinery "is, in general, mechanically sound and capable of operation on a normal basis." The report also stated that, "The present top management is now thoroughly competent and deserving of every reasonable confidence." The Kellogg report also estimated a yearly return for the refinery after certain basic improvements had been made, and stated: "This figure is [approximately one half that] . . . depicted in the so-called 'White Book—Case C'. The 'White Book' figures are grossly optimistic with respect to yields of the high quality (high price) products and operating costs." The report then recommended substantial additional capital expenditures which would, in its opinion, achieve returns comparable to those which had been originally predicted.

It appears from the record that Commonwealth and Lummus continued working together to adjust their differ-

ences until shortly before this suit was brought.[6] Lummus apparently had men working at the refinery under the contracts until at least February 1959. Meetings were held between officials of both companies and the underwriters during 1958 and 1959, the last having been held on March 24, 1959. Another was scheduled for April 24, but postponed to May 4, before which date Lummus demanded arbitration. The record also contains the affidavit of Commonwealth's president (who took office in February 1957 upon the change of management). It calls attention to the Kellogg report and seeks to establish that the figures described as "grossly optimistic" therein were based on product yields supplied by Lummus. He also seeks to rebut any inference which might be drawn from the fact that in 1958 Commonwealth also contracted with Lummus to build an additional unit costing almost $3,000,000, which unit was completed and accepted in March 1959, pointing out that at the same time Commonwealth indicated its continuing dissatisfaction with the refinery, but felt compelled to use Lummus in order to speed completion of the new unit. Finally, after first establishing his qualifications as a chemical engineer who has spent his "entire time working in or closely associated with petroleum refining, research, operation, design construction and administration," affiant states:

> "I believe that the anticipated product yields and resulting earning projections set forth in the Green and White Books were not based on sound technical estimates prepared in accordance with the standards

[6] These differences, as will be developed *infra*, did not include any charges of fraud, the basis of the present proceedings.

> of professional refinery engineering. I believe they were based on estimates which Lummus personnel, from the very nature of the engineering and economic analysis they were making, must have known were false or misleading or which they should have known were false or misleading or, else that they were prepared without any belief or any sound engineering foundation for a belief, on the part of Lummus that refinery equipment capable of attaining such yields and projected earnings could be constructed at the price it guaranteed."

There are many "or's" in this statement, but we will assume for present purposes that it asserts legal fraud.

The district court believed that Commonwealth's right to stay arbitration was governed by the Puerto Rico arbitration statute, particularly by §§ 3201 and 3204, Title 32 L.P.R.A. These sections are essentially similar to related sections of both the New York and federal arbitration acts, and we need not decide which is ultimately the governing statute.[7] Under the New York act, persons "may contract to settle by arbitration a controversy thereafter arising between them and such . . . contract shall be valid, enforce-

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[7] Questions as to the governing law of this case in a number of different contexts have been much mooted before us, but neither party has been entirely consistent in using the law it suggests as controlling. Commonwealth tells us we must look to the law of Puerto Rico but presents us with none other than the arbitration statute. Lummus contends that New York law applies, but then, in its reply brief, on the basis of the decision in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 2 Cir., 1959, 271 F. 2d 402, *cert. granted*, 362 U. S. 909, tells us that the U. S. Arbitration Act governs. If this latter be so, then of course some of its objections to the power and jurisdiction of both the Puerto Rican and New York arbitration courts collapse. We give our reasons below for applying New York law to the question of construction of the arbitration contracts, but beyond this we do not find it necessary to go.

able and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract." If arbitration is demanded and the "opposing party . . . sets forth evidentiary facts raising a substantial issue as to the making of the contract . . . , an immediate trial of the same shall be had." N. Y. Civ. Prac. Act, §§ 1448, 1458, subd. 2. See also *id.* §§ 1450, 1451. The Puerto Rican statute provides that agreements to arbitrate "shall be valid, requirable and irrevocable except for the grounds prescribed by law for the reversal of an agreement." "If the court finds that a substantial dispute has arisen as regards the validity or existence of the arbitration agreement, . . . the court shall proceed immediately to hear such dispute." "In order to give rise to [such] a dispute . . . , the party concerned shall state the proved facts on which said dispute is founded . . . ." 32 L.P.R.A. 3201, 3204(2), (4). The federal statute follows the earlier New York form and omits the word "substantial," but is otherwise not significantly different. See 9 U.S.C. §§ 2, 4.

The court granted the stay upon finding that "Commonwealth can probably prove that [Lummus'] . . . representations have in fact been proved to be false"; that "Commonwealth can introduce evidence that it relied upon these representations . . . ," and "that it would not have entered into the given contracts or perhaps any contracts with Lummus but for these representations"; and that "Commonwealth can introduce evidence tending to prove that these representations . . . were fraudulent." It then concluded: "A substantial dispute has arisen and a substantial issue exists . . . as to whether there was fraud in the inducement of the contracts . . . ." These findings are

the essential foundation for Commonwealth's case. Lummus contends that they were unwarranted. Although arguments have been presented on the issues of falsity and reliance, we believe that a substantial issue has been made out. The real difficulty lies in the question of fraudulent (or reckless) intent. We think that Commonwealth has assumed a difficult task to establish that a concern of defendant's admitted reputation and consequence not merely undertook to build a $35,000,000 refinery, but agreed to guarantee the maximum price and the performance, with reckless indifference, let alone intentional misrepresentations, as to whether that performance could be achieved. The evidence before us from which such intent or conduct could be inferred is merely the reference in the Kellogg report to the "grossly optimistic" figures of the White Book, and the conclusory allegations of Commonwealth's president. But having in mind the intangible nature of fraud, and the inherent difficulties of proof, we are short of willing to reverse the lower court's preliminary findings, and believe it preferable to look into other issues.

In his opinion supporting his order of June 19, Judge Magruder stated: "If the District Court finds the fraud to be [in the inducement] . . . , and that such fraud vitiates the whole contract, the issue of fraud obviously cannot be submitted to arbitration. The Court is thus obliged to decide preliminarily whether the contract and the arbitration clause within it are nullified by fraud. This is so under New York law as well as under Puerto Rican law. [Citation of New York cases omitted]." 174 F. Supp. 485 at 488. Judge Ruiz Nazario adopted the same approach when he ruled that, "The fraud alleged . . . would, if it

is so proved, vitiate the whole of the contracts; the issue of such fraud in the inducement is not arbitrable and cannot be submitted to arbitration." We think that this ruling, and Judge Magruder's corresponding remark that "the issue of fraud obviously cannot be submitted to arbitration." require further consideration. First, must the fraud which may have induced[*] the agreements whereby Lummus undertook to design, build, and guarantee the refineries (which contracts, minus the arbitration clauses, we shall call the principal agreements) be regarded as vitiating the undertakings to arbitrate? That is, may not the arbitration agreements be considered as separate and separable contracts even though they are physically embodied in the same instruments as the principal agreements? Secondly, if the arbitration clauses are not separable, are claims within the scope of the arbitration clause necessarily non-arbitrable, or do they merely become so by virtue of Commonwealth's election to avoid the principal agreements? And finally, if the avoidance of the principal agreements is requisite to the avoidance of the arbitration clauses, has Commonwealth properly sought to exercise that right?

Although we have assumed that Commonwealth has made a prima facie showing of voidability so far as the principal agreements are concerned, with respect to its agreement to arbitrate, considered of itself, there appear to have been no factual misrepresentations at all. If the agreement to build and the agreement to arbitrate are to be regarded as a single agreement, both promises were obtained by the

[*] No question arises in this case, or in any of the cases cited in this opinion, as to fraud in the factum, a very different matter.

one fraud, and the one must fall with the other. But, if the agreement to arbitrate is regarded as a separate undertaking, and particularly if it is broad enough to encompass any issue of fraud in the inducement, such an undertaking should not be voidable unless there was fraud directed specifically to it. Commonwealth says that this is illogical. We think not. We see no reason why parties should not agree, if they wish to, that if a question arises as to whether the principal agreement was obtained by fraud, that that question will be arbitrated. For a court then to hold that fraud which bore only upon the principal agreement automatically invalidated the arbitration contract would be to destroy precisely what the parties had sought to create. Moreover, any other approach sets the stage for delaying action, and invites the injured party to cast what is basically a claim for breach of warranty or failure to perform, which would be arbitrable, into an action based on fraudulent inducement. In some instances it may prevent even the injured party who wishes to arbitrate from doing so. The very fraud for which he wishes to recover can be used by the defrauding party to take the plaintiff's claim from the arbitrator. *Cf. Wrap-Vertiser Corp.* v. *Plotnick*, 1957, 3 N. Y. 2d 17, 163 N. Y. S. 2d 639, 143 N. E. 2d 366, *infra*. For these and other reasons, including an analysis of the language of the arbitration statutes themselves, a strong case can be made for construing arbitration agreements as separable from the principal agreements, and as voidable only for fraud directly affecting their existence, as distinguished from representations relating to the content or making of the principal agreements. See generally, *Robert Lawrence Co.* v. *Devon-*

shire Fabrics, Inc., supra, n.7; *Amicizia Societa Navegazione v. Chilean Nitrate & Iodine Sales Corp.*, 2 Cir., 1960, 274 F. 2d 805, 808-09; Parsell, Arbitration of Fraud in the Inducement of a Contract, 12 Cornell L.Q. 351 (1927); Sturges, Fraudulent Inducement as a Defense to the Enforcement of Arbitration Contracts, 36 Yale L.J. 866 (1927); Nussbaum, The "Separability Doctrine" in American and Foreign Arbitration, 17 N.Y.U.L.Q. Rev. 609 (1940).

This, however, is not a matter in which we feel free to follow our own views. *See Bernhardt v. Polygraphic Company of America*, 1956, 350 U. S. 198.* We think it clear that New York law must govern. Not only were the agreements made in New York, but the agreements to arbitrate were to be performed there. Other substantial contacts with New York include the negotiation of the agreements there, and the fact that at the time the contracts were made both parties maintained their principal executive offices there. Additionally, both contracts contained clauses stating that the contracts "shall be deemed to have been made, executed and delivered in New York, New York," a factor which indicates a choice of law by the parties themselves, as does provision for arbitration in

* In the *Robert Lawrence* case, the Second Circuit treated the separability issue as a matter of federal law under the U. S. Arbitration Act. We question whether separability is a matter of federal rather than state law in a diversity case, whether or not the federal arbitration act applies for other purposes. See 73 Harv. L. Rev. 1382 (1960); *cf. American Airlines, Inc. v. Louisville & Jefferson County Air Bd.*, 6 Cir., 1959, 269 F. 2d 811; *Ross v. Twentieth Century-Fox Film Corp.*, 9 Cir., 1956, 236 F. 2d 632. *But see* Note, 69 Yale L.J. 847, 858-61 (1960).

New York.[10] Looking to that law, we believe that the New York courts would not approach this question as we would. Although the Court of Appeals has never squarely considered the separability doctrine, it has made observations on the subject which would have to be specifically withdrawn before it could reach our suggested result. See *Wrap-Vertiser Corp.* v. *Plotnick*, *supra*. In that case, the parties had agreed to arbitrate any question "as to the validity, interpretation or performance of this agreement." Plotnick sought to arbitrate several matters, including one which the court held was a claim for damages for fraudulent inducement of the contract. The majority of the court held that this claim was not arbitrable because it did not fall within the terms of the particular arbitration clause. According to the court, the claim concerned neither "interpretation" nor "performance," and since Plotnick was affirming the contract by seeking damages rather than avoiding it by seeking rescission, the question of "validity" was not in issue. But the court went on to say that even if Plotnick had "asked for rescission, such an issue would have had to have been decided in court before it could be known that an agreement existed supplying a foundation for the jurisdiction of the arbitrators." 3 N. Y. 2d at 2[illegible]

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[10] Commonwealth contends that reference to such matters in the contracts is foreclosed by the claim of voidability. Our belief that it is not is presently supported by Restatement 2d, Conflict of Laws (Tentative Draft No. 6, April 22, 1960) §§ 332a, Comments *d* and *e*, 334b, Comment *c*. As far as significant contacts are concerned, it is true that actual construction took place in Puerto Rico. On the other hand, the designing of the refineries and the procuring of the equipment undoubtedly occurred in New York. See generally, id. §§ 332a, 332b, 334b, 334e, 354h. See also *Cruz* v. *Domingo*, 1955, 85 P.R.R. 551; *Colon* v. *Registrar of Aguadilla*, 1915, 22 P.R.R. 344; *Del Moral* v. *National City Bank*, 1937, 52 P.R.R. 221.

163 N. Y. S. 2d at 641, 143 N.E. 2d at 367. While this was only dictum, it was directly expressed. It also finds support in other New York decisions.[11] It is true that since that case the court has decided *Danann Realty Corp.* v. *Harris*, 1959, 5 N. Y. 2d 317, 184 N. Y. S. 2d 599, 157 N.E. 2d 597. There it was held that the plaintiff could not complain of fraud in the inducement of a contract to purchase a lease because of a provision in the agreement that the buyer was not relying upon any prior representations. The court said, 5 N. Y. 2d, at 321, "It is not alleged that this provision was not understood, or that the provision itself was procured by fraud." The same observation could be made in the case at bar. If fraud can be said to relate only to the "principal agreement" so as not to

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[11] It is clear that a claim of rescission based upon total breach or "fraud in the performance" does not put in issue the "making of the contract." (This phrase, as previously noted, occurs in a number of places in the New York act. The Puerto Rican act uses the more precise phrase, "validity or existence of the arbitration agreement," but it is clear that the two have been treated as equivalent.) See, *e.g.*, *Matter of Kahn*, 1940, 284 N. Y. 515, 32 N.E. 2d 534; *Lipman* v. *Hacuser Shellac Co.*, 1942, 289 N. Y. 76, 43 N.E. 2d 817; *Charles S. Fields, Inc.* v. *American Hydrotherm Corp.*, 1958, 5 A.D. 2d 647, 174 N.Y.S. 2d 184. But it has been held that a claim of fraudulent inducement does place it in issue, and "if the contract was voided by fraud the arbitration provision therein falls." *Cheney Bros.* v. *Jorgco Dresses, Inc.*, 1926, 218 App. Div. 652, 219 N. Y. Supp. 96. That case was reversed in the Court of Appeals on the ground that no fraud had been shown, but the court expressly did not pass on the separability question. 1927, 245 N. Y. 375, 157 N.E. 272. For other cases similar to *Cheney Bros.*, see, *e.g.*, *Application of Gruen*, 1940, 173 Misc. 765, 18 N. Y. S. 2d 990, *aff'd* without opinion, 259 App. Div. 712, 18 N. Y. S. 2d 1023; *Horli Chemical Sales Corp.* v. *Oliphant*, Sup. Ct., 1945, 68 N. Y. S. 2d 177; *Application of Manufacturers Chemical Co.*, 1940, 259 App. Div. 321, 19 N. Y. S. 2d 171, *app. dismissed*, 283 N. Y. 679, 28 N.E. 2d 404. The *Cheney Bros.* case is criticized by Dean Sturges in the comment noted *supra*, 36 Yale L. J. 800 (1927).

affect a provision not to assert fraud, it is doubly difficult for us to see how fraud inducing the principal agreement renders inoperative a provision for arbitration. Possibly the court now, if squarely presented with this issue, will depart from its *obiter dictum* expressed in *Wrap-Vertiser*. But for the present we feel constrained to accept as an established doctrine of New York law that an arbitration clause cannot be treated as separable from the other parts of the contract.

Of course a contract which has been fraudulently induced is not void but merely voidable, and the injured party need not avoid the contract, but may elect to affirm and seek damages in deceit. This distinction was alluded to by the Court of Appeals in *Wrap-Vertiser*. We think the inference is clear from that court's decision that a mere damage claim, even though based on fraudulent inducement, does not put in issue the "making of the contract" and may be arbitrated under a sufficiently broad arbitration clause. Both the actual holding of that case and its relevant dictum seem well stated in the following passage: "If he [Plotnick] were seeking rescission, none of the items in his arbitration demand could be arbitrated until the issue of rescission had been determined in the courts. *Even in view of his affirmance of the contract*, it is still for the courts to determine whether he has been damaged by fraud in being induced to enter into this agreement. Item 1 of Plotnick's arbitration demand does not spell out an arbitrable dispute *within the arbitration clause in this contract*." 3 N. Y. 2d at 19, 164 N. Y. S. 2d at 640-41, 143 N.E. 2d at 367 (ital. suppl.).

Appendix B

Since *Wrap-Vertiser*, the distinction between damage and rescission claims has been applied in at least two other cases.[12] In *Amerotron Corp.* v. *Maxwell Shapiro Woolen Co.*, 1957, 3 A.D. 2d 899, 162 N. Y. S. 2d 214, the court confirmed an *ex parte* arbitration award entered against Shapiro, who claimed that the contract had been induced by fraud, and who had originally brought a deceit action against Amerotron in Massachusetts. The court stated: "By all of its actions respecting its claim of fraud inducing the contract, including its complaint in the Massachusetts action, . . . [Shapiro] failed to rescind the contract and elected to recognize the contract and claim damages for fraud. Such a claim was arbitrable and should have been arbitrated under the contract." On appeal, Shapiro argued, *inter alia*, that *Wrap-Vertiser*, decided two days after the Appellate Division's decision in *Amerotron*, had established that a claim of fraudulent inducement such as Shapiro's was not arbitrable. Brief for Respondent-Appellant Maxwell Shapiro Woolen Co. in the New York Court of Appeals, pp. 8-10. The Court of Appeals, however, affirmed, without opinion, the decision below. 1958, 4 N. Y. 2d 722, 174 N. Y. S. 2d 111, 148 N. E. 2d 319.[13] In another recent case, the Appellate Division has again drawn a distine-

[12] The distinction does not appear to have received explicit consideration in any earlier New York case. It is difficult to state the reason for this, because of the brevity of the opinions and their failure to set out the facts. It would appear, however, that in most of the cases the contracts were executory and the defrauded party was merely using the fraud defensively. Commonwealth, of course, seeks much more than this.

[13] A fuller statement of this case may be found in *Maxwell Shapiro Woolen Co.* v. *Amerotron Corp.*, 1959 Mass. Adv. Sheets 851, 158 N.E. 2d 875, a related case arising out of the original tort action.

tion between rescission and damage claims. *M. W. Kellogg Co.* v. *Monsanto Chemical Co.*, 1959, 9 A.D. 2d 744, 192 N. Y. S. 2d 869, affirming the decision of the New York County Supreme Court, N.Y.L.J., April 1, 1959, p. 12, col. 4. Monsanto had sued Kellogg in Delaware, seeking damages for fraudulent inducement of a contract, negligence, and failure to perform. Monsanto also sought, in Delaware, to enjoin Kellogg from prosecuting any arbitration proceedings in New York. Kellogg countered with motions in the New York court to compel arbitration and for temporary injunctions enjoining Monsanto from further prosecuting its Delaware actions. The court granted this relief, holding that all of the claims were arbitrable under the broad arbitration clause. The Appellate Division affirmed on the basis of *Amerotron*, and distinguished *Wrap-Vertiser* because of the narrow arbitration clause there involved. The court pointed out that by seeking damages the contract had been "affirmed" by the injured parties in both cases. We believe it fair to say that on the basis of these cases there is a trend in the New York decisions, if not towards an acceptance of separability, at least in the direction of a more careful consideration of what is sought when the party opposing arbitration cries fraud.[14] We hold

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[14] See, *e.g.*, *Matter of General Fuse Co.*, 1956, 2 A.D. 2d 695, 153 N. Y. S. 2d 598, *later opinion*, 1957, 7 Misc. 2d 997, 162 N. Y. S. 2d 630, *reversed*, 1958, 5 A.D. 2d 1013, 174 N. Y. S. 2d 270; *Re Garment, Inc.* v. *Jason Corp.*, 1958, 9 Misc. 2d 521, 170 N. Y. S. 2d 412, *modified*, 6 A.D. 2d 401, 178 N.Y.S. 2d 368, *aff'd without opinion*, 6 N. Y. 2d 725, 185 N. Y. S. 2d 812, 158 N.E. 2d 505; *Bichler* v. *100 Lexington Avenue Corp.*, 1957, 4 A.D. 2d 949, 168 N. Y. S. 2d 877; *Lugay Frocks, Inc.* v. *Joint Board Dressmakers Union*, Sup. Ct., N.Y.L.J., July 1, 1958, p. 3, col. 1, *aff'd without opinion*, 6 A.D. 2d 1000, 177 N.Y.S. 2d 1008; *In re Pan American*

that unless, by means of a proper claim for rescission, Commonwealth has put in issue the "making of the contract," it cannot, by merely asserting fraud, stay the arbitration proceedings.

The purpose of an action for rescission, as distinguished from one for damages, is to permit the defrauded party to obtain restitution of the benefits conferred by him.[15] The contract is not merely terminated (as with a "rescission" based on a total breach), but is abrogated and undone from the beginning. See Black, Rescission of Contracts and Cancellation of Written Instruments § 1 (2d ed. 1929); 2 Restatement, Contracts § 349, Comment *a* (1932). With this in mind, we must determine what kind of rescission it is that Commonwealth wants, and to what kind, if any, it is entitled. The principal thrust of the complaint, the pertinent parts of which were set forth above, appears to be a tort action for damages. To this

Trade Development Corp., Sup. Ct., N.Y.L.J., Aug. 21, 1957, p. 3, col. 1; *In re East Meadow Sanitation Service, Inc.*, Sup. Ct., N.Y.L.J., Feb. 25, 1958, p. 13, col. 1; *Matter of Grossman*, Sup. Ct., N.Y.L.J., January 21, 1959, p. 14, col. 2. See also 6 Corbin, Contracts §§ 1444, 1444A (1951, and Supp. 1959). We note that in *Robert Lawrence*, the Second Circuit examined the New York cases and found them expressive of a "restrictive . . . policy." 271 F. 2d at 412. The court, however, considered neither the damages-rescission distinction, nor some of the more recent cases we have cited.

[15] The recovery of special damages for the limited purpose of putting the defrauded party back in as good a position as he occupied before entering into the contract may be awarded in connection with, and in addition to, rescission and restitution. This type of recovery is permitted by statute in New York, N. Y. Civ. Prac. Act., § 112-c, and by the better practice in other states. See study contained in the 1941 Report of the Law Revision Commission, N. Y. Legis. Doc. (1941) No. 65(L), pp. 291-344.

claim is appended a demand for: ". . . and (b) such rescission . . . as may be just and equitable . . . ." These plainly are not alternative claims, only one of which is intended to be carried through to judgment. Nor can they be claims for cumulative relief under which Commonwealth both affirms the contract and receives damages, and at the same time rescinds the contract and gets restitution. Such double recovery is nowhere allowed. The claim, therefore, must be interpreted as either for damages for deceit based upon an affirmance of part of the contract, together with rescission of part of the contract; or it must be for an entire rescission, together with such special damages as are necessary to make Commonwealth whole. On the face of the complaint, the first construction seems the proper one. The initial prayer asks for money damages almost double in amount what Commonwealth paid to Lummus, "plus other sums as yet undetermined." In addition, Commonwealth indicates no intent to return any part of the refinery. Such claims suggest an affirmance of the contracts. We note that in both Judge Magruder's order of June 19, and Judge Ruiz Nazario's order of July 20, Commonwealth's claim is termed as one for "damages," and its motion for a stay of arbitration as having been filed "in the present tort case." Commonwealth nowhere criticizes these characterizations as inaccurate. The prayer which follows, for "such rescission . . . as may be just and equitable," has the appearance of a mere claim for partial rescission appended upon the damage action. If partial rescission is what is sought, presumably it is of the provisions for arbitration. No other division is sug-

gested. However, there cannot be a partial rescission. It is fundamental that a single agreement cannot be rescinded in part and affirmed in part. 2 Restatement, Contracts § 487 (1932); 5 Williston, Contracts § 1525 at p. 4271 (Rev. ed. 1937); *In re Meiselman*, 2 Cir., 1939, 105 F. 2d 995, 998; *Merry Realty Co. v. Shamokin & Hollis Real Estate Co.*, 1921, 230 N. Y. 316, 323, 130 N.E. 306, 308. Commonwealth cannot first ask us to consider the contracts as entire and indivisible for the purpose of making the arbitration clauses voidable by virtue of fraud relating to the principal agreements, and then seek to treat the provisions as separable so as to affirm part and rescind the rest.

Our construction that no rescission of the entire contracts was intended is further supported by certain statements in Commonwealth's brief. A party who seeks restitution is, of course, normally required to make restoration of the benefits received, in specie, so that the other party, as well, can be restored to the status quo so far as possible.[18] This is the logical consequence of the action, which disaffirms the contract and returns to the defrauded party whatever he has parted with. But when faced with this prospect, Commonwealth states: "Lummus would now suggest that even if plaintiff was induced to place its economic future in Lummus' hands by fraud, Commonwealth is now bound to tender back substantially its entire business assets, its refineries, as a condition to rescinding the fraudulently induced contracts. In other words, in order to

[18] For the sake of clarity, the term "restitution" is used to denote the relief sought by the defrauded party, and the term "restoration" used to denote the return by the defrauded party of what he has received.

rescind Commonwealth must go out of business."[17] The implication of this is clear—Commonwealth has no wish to make restoration and go out of business. But if a party that has acquired a business wishes rescission, this is exactly what it must do.

Although the requirement of restoration in specie admits of a number of exceptions, most of these are of no conceivable relevancy here.[18] Certainly no exception is predicated on a choice by the defrauded party not to restore. If he does not care to restore, he should not elect to rescind. We recognize, of course, that restoration in money rather than in specie is permitted in certain instances where specific restoration is "impossible." It is to be noted that there is nothing in the record to indicate to what extent such restoration is in fact impossible. Passing this, and the important fact that Commonwealth appears not to wish to restore even that which it might be able to, we do not believe this to be a proper case for such substituted restoration. We will assume that "if specific restoration became impossible before the party seeking restitution knew the facts and had an opportunity to act thereon, restitution is granted upon the payment of value

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[17] We do not construe this protest as meaning that Commonwealth simply does not wish to make a tender, and go out of business now, as a condition precedent to litigating. Lummus made no such suggestion, nor does the law so require. See, *e.g.*, N. Y. Civ. Prac Act, § 112-g; 1946 Report of the Law Revision Commission, N. Y. Legis. Doc. (1946) No. 65(B).

[18] See Restatement, Restitution §§ 65-66 (1937); Patterson, Restoration of Benefits Received By One Entitled to Avoid a Transaction, 1946 Report of the Law Revision Commission, N.Y. Legis. Doc. (1946) No. 65(B), pp. 71-77; 5 Williston, Contracts §§ 1529-30 (Rev. ed. 1937); 5 Corbin, Contracts § 1114 (1951); Note, 29 Colum. L. Rev. 791 (1929); 32 Mich. L. Rev. 550 (1934).

or the imposition of conditions *if justice cannot otherwise be done* . . . ." Restatement, Restitution § 66(3).[19] This limited exception is not incompatible with our view that for a party to retain a valuable res (other than money or fungible goods) and make some "compensatory" credit or adjustment, is contrary to the entire concept of rescission and restitution. It is significant that we have nowhere found a case where a party has succeeded in effecting rescission, and has at the same time retained *in its own possession* all of the very res which constituted the tendered performance of the other side. Even assuming that such a result might be allowed "if justice cannot otherwise be done," we do not believe that a desire to avoid arbitration constitutes such an imperative where nothing else in the case suggests that rescission and restitution are necessary to afford Commonwealth compensation for its injury. To allow Commonwealth to rescind and to keep the fruits of the contracts by permitting it to make substituted restoration would be just another way of allowing it to rescind merely the arbitration clauses, the very part as to which there was no fraud.

There is an additional reason why Commonwealth could not effect a rescission of the principal agreements. "An unreasonable delay in manifesting an avoidance of a transaction after the acquisition of knowledge of the facts termi-

[19] This rule is in fact given as an exception, to be applied in the case of things other than chattels, to the more general rule in the Restatement that with regard to non-fungible chattels rescission cannot be had if substantial restoration in specie is not possible. We believe this may be too stringent, and therefore assume the more flexible rule quoted. We refer to the Restatement because we have found no cases, either in New York or in any other jurisdiction, which we consider to be in point.

nates the power of rescission for fraud . . . if the interests of the transferee . . . are harmed or were likely to be harmed by such delay." Restatement, Restitution § 64. See also *id.* § 68; 2 Restatement, Contracts §§ 483-84. In January 1956, an independent consulting engineer employed by Commonwealth questioned a major design feature, and stated that one of Lummus' estimates was not realistic; in October 1956, Commonwealth informed Lummus of its fears as to "possible basic inadequacies in design or construction"; and by November 1957, or earlier, Commonwealth had received the Kellogg report, with its reference to "grossly optimistic" figures, and its detailed analysis of the refinery. The record is bare as to any subsequent occurrence which threw any new light on the situation. The parties met frequently to discuss their various claims and what should be done. Not, however, until after Lummus had demanded arbitration in April 1959, did Commonwealth say anything about rescinding any agreement, or make any mention of fraud. On the contrary, as late as January 1959, Commonwealth was expressly calling upon Lummus to meet its obligations under the contracts,[20] and at least implicitly maintained that position until the institution of this suit. Throughout this period Lummus spent, accord-

[20] For example in a letter of January 15, 1959, Commonwealth's secretary and general counsel stated that although Commonwealth felt that the acceptance-test provisions of the contracts were no longer applicable, "We did not and do not mean that we think Lummus is released from any of its contractual liabilities to this Company. . . . [Y]ou are not relieved of your obligations to perform the required services under the contract." Similarly, when Lummus informed Commonwealth in February 1959 that it was withdrawing four operators at the refinery, Commonwealth's president replied, "So far as we are concerned, these operators are at the refinery under the construction contracts, but, being your employees, are of course subject to your supervision and control."

ing to an affidavit, "huge amounts of money, effort and time," which it asserts it would not have spent had it understood there was to be a claim for rescission.

Although Commonwealth filed a number of affidavits on the present motions, some of them lengthy, it has not alleged, even in conclusory form, that it acquired any new knowledge later than in the fall of 1957 by means of which it "discovered" its right to rescind. In reply to Lummus' contention that it must be taken to have affirmed the contracts well before May 1959, Commonwealth states in its brief that throughout the summer and fall of 1958 the parties were discussing the performance tests called for by the contracts, and that "as late as January 13, 1959 Commonwealth was demanding action with respect to the replacement of pumps at the refinery . . . ." These and other similar matters are described in its brief as "*significant facts indicating a recent date of discovery* of the true nature of Lummus' contract[*] . . . ." (Ital. s.ppl.) What seems to us more significant is that there is nowhere any affirmation that the discovery was, in truth, recent. The facts alleged as "indicating" that it was, indicate no more than that Commonwealth did not choose to rescind, as distinguished from not knowing that it had a right to. The closest that Commonwealth comes is a statement that "the very magnitude and technical complexity of the refineries made complete comprehension of what had occurred belated and difficult." Even this, however, is in its brief, not in any affidavit. It then adds, "The necessarily brief time available to make the presentation to the Court below precluded, of course, the most exhaustive demonstration of Commonwealth's position." Having in mind that the record

[* In the brief quoted p. 44, the word was "conduct".]

before us occupies 588 printed pages, and was evidently even larger below, we can hardly take counsel's apology as a substitute for the total absence from the record of any factual, or even conclusory, allegations on this subject. The only thing that the record shows to be newly discovered is an antipathy to arbitration.

If Commonwealth were pursuing with vigor an evident attempt to rescind the principal agreements, and had presented some, even slightly plausible, excuse for not having made its claim sooner, we might be disposed to say that an issue of fact had been made out. Instead, however, after opportunity to make a full presentation, there appears a consistent pattern of an attempt to defeat arbitration by asserting fraud as to the principal agreements, and then seeking to rescind solely the agrements [sic] to arbitrate. Commonwealth cannot blow hot and cold in the same breath. If the agreements to arbitrate are separable from the principal agreements no ground has been shown for their avoidance. If they are not separable, we hold it has shown no basis for rescission at all.[21]

Since Commonwealth failed to raise a substantial issue as to the making or the existence of the contracts, it was

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[21] In its complaint, Commonwealth asked for either rescission of the contracts under New York law, or, alternatively, "a declaration as to their inexistence under the laws of the Commonwealth of Puerto Rico." Although Commonwealth has not briefed this latter, we have given it some attention. An action for a declaration of inexistence is the proper remedy where any or all of the three essential requisites for a contract, including consent, is wholly lacking, as in a simulated contract. See § 1213 of the Civil Code, 31 L.P.R.A. § 3391; *Gonzalez* v. *Fumero*, 1928, 38 P.R.R. 497; *Logia Caballeros del Plata* v. *Garcia*, 1944, 63 P.R.R. 279; *Guzman* v. *Guzman*, 1955, 78 P.R.R. 640. There is no period of prescription (statute of limitations) for such an action. *Guzman* v. *Guzman*, *supra*, at 649. However, if a contract contains the necessary effectuating

not entitled to a preliminary stay of the arbitration proceedings. Similarly, since the preliminary injunction against Lummus rested on the granting of the preliminary stay it, too, must be vacated. No other reason for staying the arbitration has been shown. Commonwealth has not contended that Lummus' claim does not constitute an arbitrable issue within the broad provisions of the clause here in question. We believe that this question, if there could be one, is therefore, foreclosed to it. We also rule that as a matter of construction Commonwealth's claims are within the scope of the arbitration clause. We have seen that

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requisites, "although tainted with defect or vice," there is nonetheless a contract "because there is the possibility of confirming the same and this cures the defect." *Gonzalez* v. *Fumero, supra*, at 507. In other words, the contract exists but is voidable. One form of defect in the consent may be that it was obtained by deceit. Civil Code, § 1217, 31 L.P.R.A. § 3404, which includes what we have referred to as fraud in the inducement. Civil Code, § 1221, 31 L.P.R.A. § 3408; *Rivera* v. *Heirs of Diaz*, 1949, 70 P.R.R. 168; *Cruz* v. *Water Resources Authority*, 1954, 76 P.R.R. 291. If the deceit is "serious" (*dolo causante*), Civil Code, § 1222, 31 L.P.R.A. § 3409, it will give rise to an action for nullity under § 1252 of the Code; 31 L.P.R.A. § 3511. (Sections 1242-51 of [sic] of the Code, 31 L.P.R.A. §§ 3491-3500, also provide for what in Puerto Rico is termed an action for "rescission", but this is a different matter, which is not relevant here. See *Municipality of Ponce* v. *Vidal*, 1945, 65 P.R.R. 346). We think it clear that it is the action for a declaration of nullity, and not of inexistence, that would be Commonwealth's remedy under the law of Puerto Rico. See *Agostini* v. *Philippi*, 1910, 16 P.R.R. 630. The Code further provides for the restoration, upon nullification, of "the things which have been the object of the contract with their fruits, and the value with its interest . . . ." subject to certain other sections not here applicable. Civil Code, § 1255, 31 L.P.R.A. § 3514. The only case we have found permitting restoration in money rather than in specie is, on its facts, well within the exceptions recognized by common-law jurisdictions. *Forteza & Co.* v. *Colon*, 1926, 35 P.R.R. 269. The Civil Code also provides for the ratification or confirmation of a contract by conduct inconsistent with an intent to seek nullification. Civil Code, §§ 1261-65, 31 L.P.R.A. § 3520-24; *Sucn. Del Moral* v. *Mayaguez L.P. & Ice Co.*, 1939, 54 P.R.R. 141, 149. In major respects, therefore, we find the civil law to be parallel to the

under the New York cases the issue of fraud is not in itself non-arbitrable. We think that the clause here—"any controversy or claim arising out of or relating to this Agreement . . ."—is sufficiently broad to include a claim for damages based on fraudulent inducement, particularly when many of the fundamental issues involved are basically the same as would have been raised had the claim been cast as one for breach of contract. See *M. W. Kellogg Co.* v. *Monstanto* [sic] *Chemical Co., supra.*[22] As no motion to

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common law. The only difference we have discovered is one which would affect Commonwealth adversely. That is, that the action for a declaration of nullity based on deceit is subject to an extremely rigid statute of limitations of four years "from the date of the consummation of the contract." Civil Code, § 1253, 31 L.P.R.A. 3512. Apparently the running of the statute is not tolled during the period when the injured party is not aware of the deceit. See *Rivera* v. *Heirs of Diaz, supra*, at 199 (concurring opinion); *Guzman* v. *Guzman, supra*, at 649. Once the action is barred, the contract is deemed valid for all purposes. *Agostini* v. *Philippi, supra*. It would then follow that Commonwealth could not nullify the first contract which was executed July 8, 1954, effective December 3, 1953. We do not pursue the question of whether a court in Puerto Rico would also apply this statute of limitations to a cause of action which might be thought to be governed by New York law. See Restatement, Conflict of Laws § 347 (1934); Restatement 2d, Conflict of Laws (Tentative Draft No. 6, 1960) § 334b.

[22] *Wrap-Vertiser Corp.* v. *Plotnick, supra*, is not to the contrary, as the clause there was quite different. Nor is the statement in *Lipman* v. *Hacuser Shellac Co., supra* "that all acts of the parties subsequent to the making of the contract . . . lie exclusively within the jurisdiction of the arbitrators." The court was there holding that under a clause reading "any and all controversies in connection with, and/or arising out of, this contract," the defense of cancellation was for the arbitrators. Viewed in the light of that holding the court was expressing a broad, not a restrictive, arbitral jurisdiction. As the court went on to say, "this language would appear sufficiently broad to express the intention of the parties to include within the exclusive jurisdiction of the arbitrators as a general rule all acts by the parties giving rise to issues in relation to the contract, except the making thereof." 289 N. Y. at 80, 43 N.E. 2d at 819. Since we have ruled out rescission in the case at bar, the "making of the contract" is not in issue in the sense used by the court in *Lipman*.

compel arbitration is before it, we believe that the proper course is for the district court to stay its own proceedings. See *Landis* v. *North American Co.*, 1936, 299 U. S. 248, 254. If all the issues between the parties are arbitrated, or otherwise disposed of, this suit can eventually be dismissed. If, for some reason, no such solution occurs, Commonwealth can then pursue its action.

A question remains as to the appeals from the orders of June 19 and July 17. These orders expired by their terms when the court entered its order of July 20. If we were to dismiss these appeals as moot, conceivably some contention of *res judicata* might be predicated on what had been determined therein, see *United States* v. *Munsingwear, Inc.*, 1950, 340 U. S. 36; *Kelaghan* v. *Industrial Trust Co.*, 1 Cir., 1954, 211 F. 2d 134, notably, perhaps, issues involved in the order of July 17 which we are not deciding. While the likelihood of this may be remote, in view of the fact that the same errors that cause us to vacate the order of July 20 "infected" these earlier orders, we will make a similar disposition.

Judgments will be entered vacating the orders of the District Court.

APPENDIX B (continued)

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5552.

THE LUMMUS COMPANY,

DEFENDANT, APPELLANT,

v.

COMMONWEALTH OIL REFINING COMPANY, INC.

PLAINTIFF, APPELLEE;

No. 5553.

SAME *v.* SAME; and

No. 5554.

SAME *v.* SAME.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF PUERTO RICO.

Before WOODBURY, *Chief Judge*, and HARTIGAN and ALDRICH, *Circuit Judges*.

John T. Cahill, with whom *Lawrence J. McKay, Raymond L. Falk, Jr., Herbert S. McConnell, Putnam, Bell, Santry & Ray, Cahill, Gordon, Reindell & Ohl*, and *McConnell, Valdes & Kelley*, were on brief, for appellant.

John F. Dooling, Jr., with whom *Richard deV. Manning, Milton Pollack, Hamilton F. Potter, Jr., Jeffrey A. Fillman, Ruben Rodriguez-Antongiorgi, Sullivan & Cromwell* and *Fiddler, Gonzalez, Guillemard & Rodriguez* were on brief for appellee.

OPINION OF THE COURT

On Petition for Rehearing

August 10, 1960.

ALDRICH, *Circuit Judge*. Commonwealth has petitioned for rehearing, alleging that the court has "materially mis-

apprehended" the record, and that it has decided questions on which the district court was to take "further evidence." It first alleges that we could not decide, meaning should not have decided, whether restoration in specie was required. It points out that some things in fact could not be restored, and that others, not having been acquired from Lummus, did not have to be (Lummus having acted, in purchasing and paying for certain material, as Commonwealth's agent, and not as a vendor). It adds that the time was not ripe in any event to determine what restoration was called for, and charges the court with having "conclude[d] that restoration of the entire refineries be required." This is not a correct reading of our opinion. Rather, we decided that Commonwealth was not really pursuing a restitutionary remedy—a deduction there has been no serious attempt to refute—but that the true nature of the action was an endeavor to recover damages while rescinding the arbitration agreement alone. Possibly we did not adequately express our views on the New York law. Although we recognize that New York may regard an arbitration clause as falling upon a rescission of the principal agreement, we do not believe that it would carry this to the point of permitting (where the fraud in no way related to it) what in effect would be a true rescission of the arbitration clause only. The petition for rehearing confirms our belief that this is what Commonwealth is seeking.

The next portion of the petition we find somewhat extraordinary. Having, as we pointed out, alleged fraud in the district court in the vaguest and most general of terms,

Commonwealth now submits an affidavit as to what, specifically, at least in part, the fraud consisted. Then it submits an affidavit that this particular matter was discovered only in March 1959. It asserts that these affidavits should now be accepted to "preserve the court's appellate jurisdiction." There is no explanation why they were not submitted earlier, except some suggestion that the issue of the date of discovery was not ripe. However, Commonwealth's original brief did not suggest this issue was not ripe, but contended, quite ineffectually, that the record was adequate. We have devoted a sizable portion of the past several months to the complexities of this unusually difficult case. If we have erred on the record before us, we would wish to reconsider. But we have no desire to consider a new record at this stage. The affidavits will not be received.

Commonwealth's last contention is that, "Since the Court below was the first court to take hold of this matter and is the only court in which Commonwealth's claims are pending, the District Court should not stay its own proceedings unless and until Lummus establishes that Commonwealth's claims are arbitrable under the terms of the arbitration clause." What Commonwealth has partly in mind is that the arbitration clause excludes the arbitration of "claims or damages for which either party has contracts of insurance protecting their respective interests." Commonwealth fears that our statement in footnote 1, ("No issue has been raised with respect to the last sentence and we assume it has no applicability to the claims here involved."), will foreclose it from contending that some of

its claims against Lummus are not arbitrable because Lummus is protected by insurance. We of course had no such intention. We merely assumed that there was no insurance because no point was made of it. But Commonwealth goes further. It alleges that we also, in effect, decided this issue when we stated that the court below should now stay the proceedings before it, apparently overlooking the last two sentences of the penultimate paragraph of the opinion.

Basically, Commonwealth contends that the court could not stay its proceedings without a motion to that effect by Lummus. It is true that Lummus could have made such a motion as one of the means by which it could compel arbitration. But Lummus already has an action pending in New York to accomplish this very thing. The stay that we indicated is not the equivalent of the stay which would be entered upon a motion for a stay of the action under an arbitration statute. Such a stay would indeed settle all questions of arbitrability. The stay we suggested is based on the belief that there should be no further duplication of litigation in two Federal courts of concurrent jurisdiction. We intimated at the beginning of our opinion that there would have been sound reasons for the court below to have deferred initially to the New York court. Clearly now that certain issues in the case have been decided,* we see no reason for the court below to remain as the court which will supervise whatever arbitration is to be had.

* It seems late for Commonwealth to suggest that the general scope of the arbitration clause was not before the court. But we have not decided that some special exception might not exist, of which damage claims covered by insurance is an obvious example.

FILE COPY

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JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960.

No. 455.

COMMONWEALTH OIL REFINING COMPANY, INC.,

Petitioner,

against

THE LUMMUS COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF IN OPPOSITION.

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HERBERT S. McCONNELL.

October 28, 1960.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960.

COMMONWEALTH OIL REFINING COMPANY, INC.,
Petitioner,

against

THE LUMMUS COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF IN OPPOSITION.

Opinions Below.

The opinion of the Court of Appeals is reported at 280 F. 2d 915 and is printed in Appendix B to the Petition for Certiorari (pp. 37-69) and in the certified transcript (R. 7b).* The opinion of the Court of Appeals on Petition for Rehearing is also reported at 280 F. 2d 915 and is also printed in Appendix B to the Petition for Certiorari (pp. 70-74) and in the certified transcript (R. 89b).

The order of the District Court for the District of Puerto Rico, dated July 20, 1959, which was the principal order appealed to the Court of Appeals, is printed in the certified transcript (R. 331-46). No opinion was written

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*References in this Brief to the record and to the opinions of the Court of Appeals are made in the same manner used in the Petition for Certiorari (p. 2, note). References to "Appendix B" are to the Appendix to the Petition for Certiorari.

with respect to this order. The order, now moot, granting the first preliminary injunction is printed in the certified transcript (R. 304-13). The opinion with respect to that order is reported at 174 F. Supp. 485 and is printed in the certified transcript (R. 314-19). The opinion-order, also now moot, denying the motion to modify that injunction is reported at 175 F. Supp. 873 and is printed in the certified transcript (R. 327-30).

Questions Presented.

Petitioner's statement of the issues is unnecessarily convoluted and complicated. It distorts the real issues and seeks to create issues where none exist. In point of fact, the issues presented by this case are as follows:

1. (a) Whether the Court of Appeals was wrong in determining that the law of the State of New York was applicable in construing arbitration clauses embodied in contracts which were made, executed and delivered in New York, which recited that they should be "deemed to have been made, executed and delivered in New York," which provided for arbitration in New York, and which were executed by parties both of whom had their principal places of business in New York?

(b) Whether Petitioner was prejudiced by the application of New York law when no other law was cited to the District Court, when both parties consistently cited and relied on New York cases throughout the proceeding and when no significant difference was shown between New York and Puerto Rican law?

2. (a) Whether there was any impropriety in the determination of the Court of Appeals that both Puerto Rican and New York law require a party seeking to stay

an arbitration to show that there is a substantial dispute with respect to the making or existence of the arbitration agreement in order to obtain a plenary trial of that issue and an injunction *pendente lite?*

(b) Whether there was any impropriety in the determination of the Court of Appeals that the evidence before the District Court failed to show that a substantial dispute existed here?

3. (a) Whether the Court of Appeals erred in determining that no further evidentiary hearing was necessary in the District Court since Petitioner, after an ample opportunity to present evidence on all relevant issues, had failed to demonstrate that a "substantial dispute" existed with respect to the validity of the arbitration agreements?

(b) Whether the Court of Appeals erred in refusing to accept a tender of proof by Petitioner offered for the first time in support of the Petition for Rehearing in the Court of Appeals?

4. Whether, after determining that Petitioner had failed to raise a substantial issue with respect to the making or existence of the arbitration agreements, the Court of Appeals erred in instructing the District Court to stay further proceedings pending termination of the arbitration which the parties had agreed to conduct in New York?

Statement of the Case.

No effort will be made here to summarize in detail the facts contained in the 588 pages of printed record before the Court of Appeals or in the even larger record before the District Court. It is necessary, however, to correct some of the inaccuracies and omissions of Petitioner's statement.

The Contracts.

This litigation arose out of two contracts executed by Petitioner, Commonwealth, and Respondent, Lummus, whereby Lummus agreed to design and construct for Commonwealth a refinery and an expansion refinery. The two contracts were negotiated, executed and delivered in the State of New York (R. 291). Each contract contained the arbitration clause quoted in the Petition for Certiorari (p. 6) and each recited that:

> ". . . it . . . shall be deemed to have been made, executed and delivered in New York, New York." (R. 163, 176, 335).

At the time when the contracts were executed both Lummus and Commonwealth had their principal places of business in New York City (R. 109, 290, 294).

Commonwealth's statement in its Petition that the two contracts guaranteed the "performance and operability" (pp. 5-6) of the refinery and the expansion refinery is an oversimplification. It would, of course, be unusual indeed for the designer of a manufacturing plant, particularly one as complicated as an oil refinery, to guarantee that the purchaser of the plant would operate it successfully. No such guarantee was made here.

Because of the difficulty of otherwise defining the respective obligations of parties engaged in transactions as complicated as this one, each contract outlined in detail the guarantees made by Lummus and the procedure for determining whether those guarantees had been met (R. 164-70, 178-88). The effect of the guarantees was that Lummus obligated itself to construct facilities which would, during a designated acceptance-test period,* and under defined con-

* For example, the guarantees under Exhibit 10 of the original refinery contract were based on performance during any 24 hour period selected by Lummus out of a test run covering 24 to 120 hours (R. 165-66, 168).

ditions, produce from a particular crude oil a specified yield of products. Among the assumptions which formed the basis of the guarantees were the suitable operation of the facilities by an adequate number of competent personnel provided by Commonwealth (R. 164, 178) and an adequate and uninterrupted supply of utilities (R. 168, 183).

Each contract provided that, if the tests were conducted and the guarantees were not met, Lummus would make such changes in the refineries as were necessary to meet them (R. 161, 175). This provision further stated that:

> "Contractor's (Lummus') liability in respect to performance guarantees of the plant is expressly limited to the extent stated in this section." (R. 161, 175).

To make it clear that the obligations of both parties were limited to those defined in the contracts, paragraph 26.1 of each contract provided that all previous "figures, proposals and agreements" were cancelled and that no oral representation either before or after the execution of the contract would modify any obligation of either party (R. 163, 176).

Finally, each contract provided in paragraph 4.4 that if Lummus notified Commonwealth that it was ready to conduct acceptance tests and if Commonwealth failed to conduct the tests within 45 days and failed to pay the amount due to Lummus within that time "all obligations of the Contractor (Lummus) with respect to initial operations or acceptance tests or performance guarantees shall terminate and it shall be deemed that the Purchaser (Commonwealth) has automatically accepted the plant" (R. 159-60, 171-72).

Construction and operation.

Lummus proceeded to construct the two refineries. The design of the refineries was based on "well-known

processes commonly used by a number of oil companies" (R. 297). Crude oil was charged into the process units of the original refinery in January, 1956 (R. 193), and crude oil was first charged into the expansion refinery on about September 30, 1957 (R. 193-94).

Commonwealth has experienced difficulties of various kinds in operating some of the units of each refinery (R. 114-19). There are a multitude of possible causes for such difficulties. Neither the extent of the difficulties nor their possible causes have been fully explored in the present record. It was of course contemplated that questions of this kind would be explored in the arbitration upon which the parties agreed.

On at least two occasions the refineries' operations were interrupted by the first hurricanes to be experienced in Puerto Rico in 24 years (R. 101).*

One important factor is the care with which the facilities are maintained and the skill with which they are operated. In this connection it is significant that in February, 1957 extensive changes were made in Commonwealth's management (R. 109).

Acceptance tests.

Petitioner's statement that "respondent did not formally demand that petitioner conduct acceptance tests

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* The statement in the Petition that Petitioner had to expend $10,600,000 to place the refinery in an "economically operable condition" (p. 7) is not supported by the record. The record shows only that "upon completion" of a construction program designed "to achieve corrections, improvements and enlargements to the refinery" Commonwealth "will have spent" this amount. R. 60. The record does not show whether the expenditures were in fact made. It is also apparent that the expenditures were not necessary to put the refinery in an "economically operable condition." If Commonwealth had honestly felt that corrections were necessary to enable the refinery to meet the contractual guarantees, it could have, by agreeing to the conducting of acceptance tests, placed the burden on Lummus of making any such changes (R. 161, 175).

until November 11, 1958 . . ." (Petition, pp. 6-7) is misleading. Lummus first notified Commonwealth that it was ready to conduct acceptance tests under the original refinery contract in August, 1956 (R. 194). Commonwealth requested postponement of these tests because its commitments with respect to crude oil and products made it inconvenient for it to charge into the refinery the crude oil on which the guarantees were based (R. 194).

In January, 1958 the expansion refinery units were tested and passed certain Initial Operations Guarantees provided in Sections 10.2 and 10.3 of the contract of March 14, 1956 (R. 195). On February 3, 1958 the President of Commonwealth acknowledged in a letter to Lummus that these guarantees had been met (R. 214); thereafter, in May, 1958 he purported to revoke this acknowledgment (R. 250).

Shortly thereafter Lummus began preparations for a test run of the entire refinery and requested Commonwealth to do likewise (R. 196). Commonwealth had not since 1956 processed the crude oil mixtures upon which the guarantees were based (R. 196)* and it was therefore necessary for Lummus, at considerable expense, to formulate new guarantees based on the crude oil then in use by Commonwealth (R. 196). When Lummus had formulated these guarantees, Commonwealth advised that they were unacceptable, but did not specify any particular respect in which they were deficient (R. 196). Lummus also advised Commonwealth that the refinery had not been properly maintained and described maintenance work necessary to prepare it for tests (R. 196). On September

* There is of course a great difference in the composition of crude oils and in the products which can be obtained from them. Product guarantees must therefore be based on the use of particular crude oils or crude oil mixtures.

17, 1958 the parties held a meeting in New York at which Lummus pressed for the conducting of tests and Commonwealth resisted them (R. 197).

In order to cooperate in making acceptance tests possible at minimum cost and inconvenience Lummus offered to postpone the tests until after Commonwealth's first periodic shutdown for required maintenance or after the installation of a new process unit then under construction. This offer was refused by Commonwealth. When Commonwealth persisted in its refusal to conduct tests, Lummus demanded on November 11, 1958 that acceptance tests in accordance with each contract be conducted within 45 days. Again Commonwealth refused to conduct the tests (R. 197).

Commonwealth has thus frustrated every effort by Lummus to conduct the tests which are the only means of determining whether the contractual guarantees can be satisfied.

Commencement of litigation.

Commonwealth has withheld payment of $4,697,997.85 which it owes to Lummus for work performed and materials supplied in connection with the contracts (R. 17-18, 198). On April 29, 1959 Lummus demanded arbitration under its two contracts with Commonwealth of its claims against Commonwealth in this amount and of "any set-offs or counterclaims . . . which Commonwealth may assert" (R. 17-18). The demand for arbitration was admittedly received by Commonwealth on April 30, 1959. Under New York law arbitration is a "special proceeding" (N. Y. Civil Practice Act §1459); the special proceeding is commenced by the demand for arbitration.*

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* *E.g., Fay* v. *Phenix Soda Fountain Co.*, 153 N. Y. S. 2d 153 (Sup. Ct. Kings Co. 1956); *Shine's Restaurant, Inc.* v. *Waiters and Waitresses Union*, 113 N. Y. S. 2d 315, 317 (Sup. Ct. N. Y. Co. 1952).

On May 4, 1959 Commonwealth commenced an action against Lummus in the District Court for the District of Puerto Rico (R. 7, 335). At the same time Commonwealth moved in that Court pursuant to 32 L. P. R. A. §3204 (4) (a) for a stay of the arbitration which Lummus had demanded. Both the action and the motion for stay were based upon Commonwealth's allegations that certain studies and projections prepared by Lummus prior to the execution of the contracts were either fraudulently misleading or constituted negligent misrepresentations (R. 7-12).

Until the commencement of this suit on May 4, 1959 Commonwealth had in no way suggested that Lummus was guilty of fraud or that Commonwealth regarded the contracts between the parties or the arbitration clauses embodied in them as fraudulently induced or subject to rescission.

Indeed Commonwealth had consistently indicated until that time that it regarded the contracts as valid and subsisting and intended to rely upon them (R. 205-09). For example, on January 15, 1959 Mr. Manning, Secretary and General Counsel of Commonwealth, wrote to Lummus stating that:

> "We did not and do not mean that we think Lummus is released from any of its contractual liabilities to this company."

He went on to say that:

> " . . . you are not relieved of your obligation to perform the required services under the contract" (R. 261).

On May 20, 1959 Lummus served a petition, filed in the New York County Supreme Court, to compel arbitration. On May 25, 1959 Commonwealth filed in the United

States District Court for the Southern District of New York a petition for removal of Lummus' action pending in New York County (R. 337).

On the morning of May 29, 1959 counsel for Lummus advised counsel for Commonwealth that they would present that afternoon to the District Court for the Southern District of New York an order to show cause why Commonwealth should not be enjoined from any further proceedings in the action which it had instituted in Puerto Rico pending final disposition of the New York suit and would ask the District Court for a temporary restraining order pending a decision on the motion for injunction (R. 337-38). Commonwealth's counsel thereupon applied to the District Court in Puerto Rico, without notice to counsel for Lummus, for an order restraining further proceedings in the suit pending in New York. This restraining order was issued by the Puerto Rican Court within a matter of a few hours and the District Court in New York was advised of its issuance during the course of the hearing on submission of the order to show cause.

The temporary restraining order issued by the District Court in Puerto Rico on May 29, together with the subsequently issued orders described in the Petition for Certiorari, have prevented any further proceedings in New York up to the present time.

The District Court's order of July 20, 1959.

On July 20, 1959 Judge Ruiz entered the order which was the principal order before the Court of Appeals and which superseded the preceding preliminary orders. This order enjoined Lummus from taking any further action in the New York arbitration proceedings pending a trial of Commonwealth's allegations of fraudulent inducement (R. 331-46). The order contained findings of fact and con-

clusions of law, but Judge Ruiz wrote no opinion. The principal conclusions of the District Court were the conclusion that the issue of fraud in the inducement of the contracts between Lummus and Commonwealth was not an arbitrable issue under the terms of the arbitration agreements and the conclusion that the evidence adduced by Commonwealth raised a "substantial dispute" with respect to the validity and existence of the arbitration agreements. This determination that a substantial dispute existed was, under both the Puerto Rican and the New York statutes, a prerequisite to the conducting of a plenary trial to determine the validity of the arbitration agreements.

The opinion of the Court of Appeals.

On appeal to the United States Court of Appeals for the First Circuit Lummus challenged the order of the District Court on a number of grounds. Neither the issues presented to the Court of Appeals nor the grounds of its decision are made clear in the Petition. Since the issues presented to the Court of Appeals are clearly stated in its opinion, no attempt will be made to detail all of those issues here.*

The issues which the Court of Appeals found to be dispositive of the case went to the merits of Commonwealth's motion for stay of arbitration.

Lummus contended, first, that an arbitration clause is separable from the agreement in which it is embodied. Thus, the question whether the principal agreement was fraudulently induced and may be rescinded is an issue which is arbitrable under an arbitration clause, such as the

* It should be noted that the Court of Appeals found it unnecessary to decide certain issues. (Appendix B, pp. 43-44). If this Court were to grant certiorari and thereafter reverse the decision of the Court of Appeals, it would be necessary to remand the case to the Court of Appeals for determination of these issues.

one involved here, which is broad enough to encompass such an issue. Since all of the issues raised by Commonwealth were arbitrable issues, there was no basis for a stay of the arbitration and it should be permitted to proceed.

Lummus next contended that, even if a claim for rescission based on allegations of fraudulent inducement is not an arbitrable issue, the evidence before the District Court showed that no substantial dispute existed with respect to the question of fraud or the claim for rescission.

The Court of Appeals dealt with these issues with great care and thoroughness.

The Court held that under the New York law, which it was obligated to apply, "an arbitration clause cannot be treated as separable from the other parts of the contract," (Appendix B, page 56), and that fraud going to the principal contract may, therefore, invalidate the arbitration clause. The Court held, however, that "unless, by means of a proper claim of rescission Commonwealth has put in issue the 'making of the contract,' it cannot by merely asserting fraud, stay the arbitration proceeding" (Appendix B, p. 59).

The Court of Appeals found that Commonwealth had not put in issue the making of the contract by means of a proper claim for rescission. Commonwealth's claim was deficient in two respects. First, Commonwealth's conduct prior to and throughout the proceedings demonstrated that it was not making a *bona fide* effort to rescind the contracts between the parties in their entirety. The Court inferred from this conduct, and principally from the fact that Commonwealth obviously had no desire that the parties be restored to their positions prior to the making of the contracts, that the only rescission sought by Commonwealth was of the arbitration clauses themselves. The Court pointed out that a partial rescission of this character is not permissible.

The Court also held that the evidence showed that Commonwealth had unreasonably delayed in manifesting its intent to avoid the contracts and had affirmed the contracts by its words and its actions. As the Court pointed out, Commonwealth called upon Lummus to perform under the contract as late as January, 1959, and "at least implicitly maintained that position until the institution of this suit." (Appendix B, p. 64.)

Nor did Commonwealth point to any recently discovered information which explained the delay in asserting the claim of fraud. Thus the Court pointed out that:

> "Although Commonwealth filed a number of affidavits on the present motions, some of them lengthy, it has not alleged, even in conclusory form, that it acquired any new knowledge later than in the fall of 1957 by means of which it 'discovered' its right to rescind" (Appendix B, p. 65).

The Court referred to "the total absence from the record of any factual, or even conclusory, allegations on this subject" (Appendix B, p. 66). As the Court pointed out:

> "The only thing that the record shows to be newly discovered is an antipathy to arbitration" (Ibid.).

The basis for the decision of the Court of Appeals is well summed up in the following language:

> "If Commonwealth were pursuing with vigor an evident attempt to rescind the principal agreements, and had presented some, even slightly plausible, excuse for not having made its claim sooner, we might be disposed to say that an issue of fact had been made out. Instead, however, after opportunity to make a full presentation there appeared a consistent pattern of an attempt to defeat arbitration by asserting fraud as to the principal agreements, and then seeking to rescind solely the agreements to arbitrate" (Appendix B, p. 66).

The Petition for Rehearing

Commonwealth filed a Petition for Rehearing. The principal argument in the Petition for Rehearing was characterized by the Court of Appeals as "somewhat extraordinary" (Appendix B, p. 71). The Court of Appeals had held that Commonwealth's claim for rescission was deficient, in part, because it was tardily made and there was no evidence that the grounds for rescission had been recently discovered. In its Petition for Rehearing Commonwealth sought to adduce evidence, which had not been adduced below, to the effect that the grounds for rescission had been recently discovered. The Court of Appeals held that it was too late for Commonwealth to supplement the record and refused to receive the affidavits.

Since Commonwealth's affidavits were not received, Lummus has had no opportunity to rebut the allegations of those affidavits. It should be noted, however, that the affidavits themselves reveal that all of the material contained in them was in Commonwealth's possession two months before Commonwealth's action was brought and several months before the record was made in the District Court. Commonwealth nowhere explains why, if the facts alleged in these affidavits were the facts which first persuaded Commonwealth that fraud had been committed and that it had a right to rescind, there was no reference whatever to those facts in Commonwealth's papers in the District Court.

Argument.

The Court of Appeals carefully and accurately applied the principles of local law which are determinative of this controversy. The thoroughness of the Court's opinion and the force of its reasoning demonstrate that no review by this Court is necessary. Moreover, since the issues pre-

sented here turn on questions of local law and analysis of the voluminous record in the District Court, no question appropriate for consideration by this Court is tendered.

Commonwealth's Petition for Certiorari is an exercise in calculated obfuscation. It mingles separate issues in an argumentative *hodge-podge*. An effort is made in this Brief to consider the issues separately and in logical order.

I.

The Court of Appeals made the proper choice of law and, in any event, Petitioner was not prejudiced by that choice of law.

The Petition for Certiorari fails to make it clear that two separate choice-of-law problems were considered by the Court of Appeals.

First, there was the question what test should be applied in determining whether a sufficient basis had been laid for the holding of a plenary trial on the issues raised by the motion to stay arbitration. On this issue the Court of Appeals noted that there was no difference between the Puerto Rican and the New York law and that it was, therefore, unnecessary to choose between them (Appendix B, p. 48). The Court of Appeals pointed out that the Puerto Rican statute provides that the Court may proceed to a full hearing on a dispute as to the validity or existence of an arbitration agreement only if it is shown that a "substantial dispute" exists. The Court pointed out that under the New York statute a "substantial issue" must be raised as to the "making of the contract" in order to warrant a trial of that issue. No difference is discernible between these two tests.

Although the District Court had stated that the Puerto Rican statute was applicable it had pointed to no distinction between that statute and the New York

Indeed, in arguing to the District Court Commonwealth itself stated that there was no difference between the two statutes in this respect. In a memorandum submitted to the District Court Commonwealth described the procedure under the Puerto Rican statute and then stated:

> "The law of New York Civil Practice Act, § 1450 provides essentially the same procedure . . ."*

In arguing orally to the District Court, counsel for Commonwealth also emphasized that the New York and Puerto Rican statutes have the same effect. As he pointed out, motions under 32 L. P. R. A. § 3204 and under § 1450 of the New York Civil Practice Act tender "exactly the same issue. . . ."** Thus there was no disagreement between the Court of Appeals and the District Court, or between either Court and Commonwealth, with respect to this issue.

The second and separate choice-of-law question was what law should be applied in construing the contracts containing the arbitration clauses, in determining the scope of those clauses, and in determining whether the arbitration clauses were separable from the contracts in which they were embodied.

The only bodies of law which have been considered with respect to these questions at any time in these proceedings are the New York law and the federal law.

Lummus suggested in its reply brief in the Court of Appeals that by virtue of the decision in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2d Cir. 1959), federal law might properly be applied in determining these questions. In a Rejoinder Brief submitted by Common-

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* Plaintiff's Memorandum of Law in Support of Its Motion Set for Hearing June 1, 1959, p. 10.

** Transcript of hearing of June 1, 1959, p. 54.

wealth it was contended that the *Devonshire* case was wrongly decided and state rather than federal law should apply. The Court of Appeals rejected the view of the *Devonshire* case (Appendix B, p. 53, note 9). Thus there is no issue now raised with respect to the question whether federal or state law should apply.* The only question remaining is whether Puerto Rican or New York law should properly be applied in construing the contracts and the arbitration clauses contained therein.

Since Judge Ruiz wrote no opinion in connection with his order of July 20, 1959, he did not explicitly state what law he was applying with respect to these issues. He did, however, accept Commonwealth's contention that the issue of fraud in the inducement of a contract is not arbitrable and cannot be submitted to arbitration. The authority cited by Commonwealth in support of this proposition consisted entirely of New York cases. Judge Magruder, in considering this issue in his opinion supporting the preliminary order which he entered, relied entirely on New York cases (R. 319). In its brief in the Court of Appeals Commonwealth relied exclusively on New York authority and, indeed, cited not a single Puerto Rican case in discussing these issues.

It is in the face of this consistent reliance on New York law by everyone concerned that Commonwealth seeks now to fabricate a conflict of laws question for consideration by this Court. It is immediately apparent that the Court of Appeals did not disregard or ignore a choice of law made by the District Court. On the contrary, there was no significant issue as to which law applied.

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* It should be emphasized that none of the issues tendered by the Petition for Certiorari in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.* is presented here. The first issue presented in *Devonshire* was the question whether federal or state law should be applied—an issue now moot here. The remaining issues in *Devonshire* related to the content of [illegible]
Court [illegible]

Nor does Commonwealth, even in its Petition for Certiorari, point to any difference between the New York and the Puerto Rican substantive law which is relevant to the determination whether or not the arbitration should be stayed. The only difference to which Commonwealth points is with respect to the grounds on which the arbitration award may be set aside (Petition, p. 15).* This of course has nothing to do with the question whether Commonwealth has shown the existence of a substantial dispute sufficient to require a plenary hearing or the question whether the arbitration should be stayed. Since there is no demonstrated difference between the New York and Puerto Rican law, Commonwealth's alleged conflict of laws issue is mere shadow boxing.

Even if there were a conflict of laws issue and even if the choice of law made some difference, it is perfectly apparent that under any relevant conflict of laws principle the Court of Appeals properly applied New York law. The contracts containing the arbitration clauses were negotiated and executed in New York. The parties specified that the arbitration was to take place in New York. The parties specifically indicated their intention that New York law apply by reciting in the agreement that it should be "deemed" made, executed and delivered in New York. In holding that the New York law was applicable the Court of Appeals relied on the Restatement of the Conflict of Laws and on a series of Puerto Rican cases (Appen-

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* Even this difference evaporates upon analysis. Under Section 1462 of the New York Civil Practice Act an arbitration award may be set aside if the arbitrators refuse to hear evidence "pertinent and material to the matter in controversy." *Gervant* v. *New England Fire Insurance Co.*, 306 N. Y. 393, 400, 118 N. E. 2d 574 (1954). It does not appear that this standard is different from the provision of Section 22(c) of the Arbitration Law of Puerto Rico, 32 L. P. R. A. §3222(c), that the award may be set aside where the arbitrators refuse "to hear relevant and material evidence on the dispute. . . ."

dix B, p. 54, footnote 109. Commonwealth, while complaining vociferously that the wrong conflict of laws rule has been applied, suggests no other rule and points to nothing from which such a rule might be inferred.

Commonwealth argues that the action of the Court of Appeals was contrary to this Court's ruling in *Bernhardt v. Polygraphic Company of America*, 350 U. S. 198 (1956) requiring that a District Court apply the conflicts rule of the state in which it sits. In the first place, there is some question whether the rule of the *Bernhardt* case is applicable to a federal court sitting in Puerto Rico since the Rules of Decision Act, 28 U. S. C. 1652, does not apply in territories of the United States. *Waialua Agricultural Co. v. Christian*, 305 U. S. 91, 109 (1938).* Although a federal court is bound to give some deference to the rulings of territorial courts, *Waialua Agricultural Co. v. Christian, supra*, at 109, it is not bound to the local rule where that rule does not relate to matters of "local practice, customs or law." *In re Sawyer*, 360 U. S. 622, 640 (1959). Since the Puerto Rican courts have indicated that they will follow the conflict of laws principles applied in the continental United States, *Cruz v. Dominguez*, 9 P. R. R. 551 (1905); *Colon v. Registrar*, 22 P. R. R. 344 (1915), it can hardly be said that the conflicts rule is a local matter. For the same reason Commonwealth derives little support from the principle requiring a Court of Appeals to give deference to a local court's construction of local law where that law applies. *E.g., De Castro v. Board of Commissioners of San Juan*, 322 U. S. 451 (1944). The District Court has no greater expertise than the Court of Appeals in applying general principles of the conflict of laws. Moreover, Commonwealth

* It is not clear whether Puerto Rico should be regarded as a "territory" for this purpose. *Cf. Mora v. Mejias*, 206 F. 2d 377, 387 (1st Cir. 1953).

ignores this Court's ruling that it will itself defer to determinations of the Courts of Appeals with respect to questions of local law. *E.g., Byrd* v. *Blue Ridge Rural Electric Cooperative, Inc.*, 356 U. S. 525, 529-30 (1958); *rehearing denied*, 357 U. S. 933; *Ragan* v. *Merchants Transfer & Warehouse Co.*, 337 U. S. 530, 534 (1939).

In any event, none of these problems is raised here since the Court of Appeals did not disagree with the District Court as to the conflicts rule to be applied, no substantive law other than the law of New York has ever been cited, and no difference has been shown to exist between the New York and the Puerto Rican law.

II.

The Court of Appeals correctly held that no substantial issue had been raised with respect to the validity of the arbitration agreements.

The Court of Appeals carefully analyzed the New York law which it found to be applicable and carefully examined the record and the findings of the District Court. The Court of Appeals concluded that, in order to avoid arbitration, Commonwealth was required to demonstrate the existence of a substantial issue with respect to the validity of the arbitration agreements. The Court further concluded that such a demonstration required a showing that a bona fide rescission of the contracts containing the arbitration clauses had been sought and that Commonwealth's claim for rescission was at least plausible. In so holding, the Court of Appeals adopted the construction of the New York law which was most favorable to Commonwealth. The Court of Appeals concluded, however, that Commonwealth had failed to raise a substantial issue

because it had made no bona fide claim for rescission and, in any event, rescission was not permissible because of Commonwealth's delay in asserting its claim and its affirmance of the contracts.

Commonwealth's principal attack on the determination of the Court of Appeals is a suggestion that the Court has somehow abused its proper function in reviewing the decision of the District Court.

The Court of Appeals construed the New York law in the way most favorable to Commonwealth.

Lummus argued in the Court of Appeals, as it had in the District Court, that an arbitration clause is separable from the contract in which it is embodied and that where the clause is broad enough to include an allegation of fraud such an allegation is arbitrable even when it is joined with a proper claim for rescission. If the Court of Appeals had accepted this view of the New York authorities, this would have been sufficient to dispose of the case in Lummus' favor.

The Court of Appeals, while it recognized the wisdom of the rule for which Lummus contended, was unable to derive that rule from the New York cases.* It pointed out, however, that even under the New York authorities it was essential for the party seeking to avoid arbitration to join

* Cases decided since the submission of this case to the Court of Appeals indicate that Lummus' view of the New York law is correct and that an arbitration clause should be regarded as separable. For example, in *Fabrex Corp.* v. *Winard Sales Co.*, 200 N. Y. S. 2d 278 (Sup. Ct. N. Y. Co. 1960) the Court said:

> "Where an arbitration clause is broad and all inclusive, a request for rescission, either, in a pending action or in a demand for arbitration, based upon fraud in the inducement, will be left for determination of the arbitrators [citations omitted]." (200 N. Y. S. 2d at 280). See also *Matter of Soriano*, 113 N. Y. L. J. No. 39, p. 14, col. 5 (Sup. Ct. N. Y. Co. Feb. 29, 1960).

with his claim of fraud a proper claim for rescission of the contracts. It is not open to dispute that under the New York authorities the party seeking to stay arbitration must do at least this much. This is clear, for example, from a case such as *Amerotron Corporation* v. *Maxwell Shapiro Woolen Company*, 3 App. Div. 2d 899, 162 N. Y. S. 2d 214 (1st Dep't 1957), *aff'd* 4 N. Y. 2d 722, 148 N. E. 2d 319 (1958).

Commonwealth makes no serious effort to challenge this ruling. It does not, in its Petition, make any effort to discuss the New York cases. Commonwealth limits itself to the suggestion that the "preference" of the Court of Appeals for the rule applied in *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959) led it to hold that "an acknowledged principle of New York law yielded to the court's preferred rule of the severability of arbitration clauses. . . ." (Petition, p. 19). It is, of course, clear that the Court of Appeals did no such thing. It found that this was "not a matter in which we feel free to follow our own views" (Appendix B, p. 53). The Court concluded that it was "clear that New York law must govern" (Appendix B, p. 53) and proceeded to apply that law with great care.

The analysis by the Court of Appeals of the record below was correct.

Nor does Commonwealth make any serious effort to challenge the factual underpinnings of the decision of the Court of Appeals. Rather it argues that it should be given another opportunity to adduce evidence which it failed to adduce in the District Court.

Nowhere does Commonwealth's Petition point to any evidence whatever in the record before the District Court

showing that its claim for rescission was timely or that there was any reason for the long delay which occurred before that claim was asserted. Commonwealth spread on the record the evidence upon which it relied in support of its claim of fraud. That evidence itself demonstrated that all of the facts were known to Commonwealth in 1957. As the Court of Appeals pointed out "the record is bare" as to any occurrence subsequent to November, 1957 which threw any new light on the situation or which could have persuaded Commonwealth that a fraud had been committed (Appendix B, p. 64). Yet it was not until after Lummus had demanded arbitration in April, 1959 that Commonwealth made any claim of rescission or said anything about fraud. As the Court of Appeals also indicated, Commonwealth failed to show even a "slightly plausible" excuse for not having made its claim sooner. The record is abundantly clear that no timely claim of rescission was made.

It is equally apparent that the demand for recission, even when it was made, was inadequate. The Court of Appeals, after a thorough examination of Commonwealth's conduct and of the statements in its brief to the Court of Appeals concluded that Commonwealth had filed a damage action with a "mere claim for partial rescission appended" (Appendix B, p. 60). In denying Commonwealth's Petition for Rehearing the Court pointed out that Commonwealth had made "no serious attempt to refute" its deduction that Commonwealth was not really pursuing a restitutionary remedy and, indeed, found confirmation in the Petition for Rehearing for that deduction (Appendix B, p. 71). Commonwealth, in its Petition to this Court, now makes some effort to contend that the Court of Appeals misread its intention.

Commonwealth suggests that the Court of Appeals must have been wrong because Lummus never read the complaint as the Court of Appeals did. In this Commonwealth errs. For example, in an affidavit filed by counsel for Lummus in opposition to Commonwealth's motion for stay of arbitration the complaint was characterized as involving "essentially a claim for damages *ex delicto*" (R. 150). Similarly, in arguing before the District Court on June 1, 1959 counsel for Lummus stated that:

> "... what this court has before it is primarily an action for damages."*

In the same vein, counsel for Commonwealth stated:

> "The question before this Court in this proceeding is essentially a question of tort."**

The Court of Appeals correctly concluded that Commonwealth had not sought and was not seeking a rescission of the entire contracts and a restoration of both parties to their positions prior to the execution of the contracts.

It is submitted that the record amply supports the conclusion of the Court of Appeals that Commonwealth's conduct was the result of "an antipathy to arbitration" and that Commonwealth failed to raise a bona fide and substantial issue with respect to the validity of the arbitration agreements (Appendix B, p. 66).

The Court of Appeals did not interfere with any exercise of discretion by the District Court.

Commonwealth suggests that the Court of Appeals in some way interfered in an improper way with an exercise of discretion by the District Court. Thus Commonwealth

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* Transcript of June 1, 1959, p. 32.

** Transcript of June 1, 1959, p. 50.

characterizes the District Court's decision as "discretionary" (Petition, p. 20). Commonwealth goes on to suggest that the Court of Appeals first held that the District Court had not abused its discretion and then "invaded" the discretion of the District Court and rendered a decision "repugnant" to its own earlier determination that no abuse of discretion existed (Petition, p. 21).

In making this argument Commonwealth confuses two separate determinations which the Court of Appeals made. The Court of Appeals first considered whether the District Court had abused its discretion in determining that the motion to stay arbitration pending in Puerto Rico should be allowed to proceed and the action to compel arbitration pending in New York should be stayed. This was a question which had nothing to do with the merits of the motion to stay arbitration. It was merely a question which of two pending federal suits should be allowed to proceed. If the Court of Appeals had found an abuse of discretion, it would have been unnecessary to consider at all the merits of Commonwealth's motion for stay of arbitration. Although the Court of Appeals found that "there were sufficient reasons which would have justified . . . [the District Court] as a matter of discretion, in staying its own proceedings in favor of those in New York" (Appendix B; p. 43), the Court of Appeals held that there was no abuse by the District Court of its discretion.

Having made this determination, the Court proceeded to the merits of Commonwealth's motion to stay. Here there was no question of discretion involved. Under both the New York and Puerto Rican statutes Commonwealth was required to make an affirmative showing that a substantial dispute existed with respect to the validity of the arbitration clauses before a plenary hearing on this issue could be held. Unless there was a sufficient basis for the

holding of a plenary hearing, there could, of course, be no ground for the issuance of a preliminary injunction pending such a hearing.

The Court of Appeals therefore considered the legal question whether the District Court's determination that a substantial dispute existed was correct.* It held that no substantial dispute existed and thus disposed of the motion to stay on the merits. This disposition was in no way contrary to the Court's earlier determination that the District Court had not abused its discretion in entertaining the motion.

The Court of Appeals did not infringe upon the fact-finding function of the District Court.

Commonwealth next suggests that the reversal by the Court of Appeals of the District Court's ruling that a substantial dispute existed somehow impaired or infringed upon the fact-finding role of the District Court. It is apparent that there was no such impairment or infringement.

The issues with respect to which the District Court and the Court of Appeals differed were not issues of fact, but

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* At pages 23 and 24 of the Petition, Commonwealth cites a long list of cases for the proposition that the issuance of a preliminary injunction is a matter resting within the discretion of the District Court. Although this principle is sound, it does not deprive the Court of Appeals of the power to consider whether the issuance of the preliminary injunction was based upon an error of law or an error in applying the law to the facts. Thus in *W. A. Mack Inc.* v. *General Motors Corporation*, 260 F. 2d 886, 890 (7th Cir. 1958), relied on by Commonwealth, the Court of Appeals considered whether the complaint in the action made out a *prima facie* case. See also, *e.g.*, *Clemons* v. *Board of Education of Hillsboro*, 228 F. 2d 853, 857-58 (6th Cir. 1956), *cert. denied*, 350 U. S. 1006 (1956); *Mitchell* v. *Raines*, 238 F. 2d 186 (5th Cir. 1956); *In re Central Railroad Co. of New Jersey*, 163 F. 2d 44, 53 (3rd Cir. 1947), *cert. denied, sub nom. Gardner* v. *State of New Jersey*, 332 U. S. 810; *Booth* v. *United States*, 154 F. 2d 73 (9th Cir. 1946); *Ring* v. *Spina*, 148 F. 2d 647, 650 (2d Cir. 1945), *cert. denied*, 335 U. S. 813 (1948).

were rather questions with respect to the application to the facts of relevant legal principles. The requirement of Rule 52 that findings of a District Court be set aside only when "clearly erroneous" does not apply to mixed questions of fact and law or to determinations of the legal significance of evidentiary facts. *E.g., United States* v. *United States Gypsum Co.*, 333 U. S. 364, 396 (1948); *Lehmann* v. *Acheson*, 206 F. 2d 592, 594 (3rd Cir. 1953); *Stevenot* v. *Norberg*, 210 F. 2d 615, 619 (9th Cir. 1954).

The Court of Appeals accepted the factual findings of the District Court, rejecting only its ultimate conclusion that a substantial dispute had arisen with respect to the validity and existence of the arbitration agreements. Although the Court of Appeals expressed some skepticism with respect to these findings (Appendix B, pp. 49-50), it was unwilling to set them aside. The Court of Appeals held, however, that neither these findings nor the evidence submitted by Commonwealth showed the existence of a substantial dispute. Rather the record clearly demonstrated that, since Commonwealth was not seeking a complete rescission and had not made a timely claim for rescission, a substantial dispute did not exist.

Even if it were assumed that some additional findings by the District Court might have been helpful to the Court of Appeals in considering the case, it would not follow that the absence of those findings precluded a final disposition of the matter by the Court of Appeals. It is clear that, even where findings are omitted, the Court of Appeals may retain and dispose of the case rather than remanding it for further findings. *E.g., Yanish* v. *Barber*, 232 F. 2d 939, 947 (9th Cir. 1956); *Food Fair Stores, Inc.* v. *Square Deal Market Co., Inc.*, 206 F. 2d 482, 484, note 3 (D. C. Cir. 1953), *cert. denied*, 346 U. S. 937 (1954); *Westley* v. *Southern*

Railway Co., 250 F. 2d 188, 189 (4th Cir. 1957), *rehearing denied*, 252 F. 2d 79 (1958); *Smith* v. *Dravo Corp.*, 208 F. 2d 388, 391-92 (7th Cir. 1953).

The findings and conclusions of the District Court were adequate to give the Court of Appeals a full understanding of the questions involved. The decision of the Court of Appeals did not turn on any weighing of contradictory evidence, but rather on the failure of Commonwealth to seek a true rescission, the failure of Commonwealth to suggest any plausible reason for delay in demanding rescission, and undisputed facts in the record showing that all of the information upon which Commonwealth relied in asserting its claim of fraud had been in Commonwealth's possession over a long period of time. Under these circumstances it is plain that no further findings were necessary.*

The Court of Appeals properly refused to give Commonwealth a second opportunity to prove its case.

Commonwealth's next argument is that since it failed in its first effort to prove the existence of a substantial dispute with respect to the validity of the arbitration agreements, it should now be given a second chance. No persuasive reason appears, however, why such a second chance should be afforded to it.

In arguing that it is entitled to another opportunity to prove its case Commonwealth relies on cases like *Fountain*

* The cases cited by Commonwealth are not to the contrary. *Sartor* v. *Arkansas Natural Gas Corp.*, 321 U. S. 620 (1944) and *Kennedy* v. *Silas Mason Co.*, 334 U. S. 249 (1948), cited at p. 27 of the Petition, have nothing to do with the circumstances under which a case must be remanded for further findings. Both of those cases dealt only with the circumstances under which a summary judgment may be granted. The *Sartor* case, for example, stands only for the familiar proposition that a summary judgment may not be granted on the basis of inconclusive affidavits by interested witnesses.

v. *Filson*, 336 U. S. 681 (1949) (Petition, p. 23) and *Byrd* v. *Blue Ridge Rural Electric Cooperative, Inc.*, 356 U. S. 525 (1958) (Petition, p. 22). Those cases have no application. There a party had been deprived of the opportunity to submit evidence on a particular issue because of a preliminary ruling in his favor which made such proof unnecessary. Of course this Court held that, when the legal ruling in his favor was reversed, the party must be afforded an opportunity to submit evidence on the remaining factual issue, before it was resolved against him.

Commonwealth suggests that the District Court here "deferred consideration" of the issue of the timeliness of Commonwealth's claim and that there was a "void in the record" with respect to that issue (Petition, p. 21).

It is clear, however, that Commonwealth has had a full opportunity to submit evidence on every question relevant to the determination whether a substantial dispute existed. Inspection of the order of the District Court reveals that the Court did not defer for a later hearing the issue whether Commonwealth had made a timely demand for rescission. Indeed, it had no power to do so. Under the applicable statute the Court could conduct a plenary hearing on the motion for stay of arbitration only after it had first determined that a substantial dispute had been shown to exist. It would be beyond its power to order a plenary hearing without finally determining whether there was a substantial dispute and ruling on every subsidiary issue relevant to that determination.

Nor was there a void in the record. Lummus introduced uncontradicted documentary evidence which affirmatively proved that Commonwealth had affirmed the contracts. The proof submitted by Commonwealth itself demonstrated that all of the facts relied upon in support of the claim of fraud had long been in its possession. The

record was complete and clear. Commonwealth's only objection to that record is that it does not prove what Commonwealth would like it to prove.

Until the filing of the Petition for Rehearing in the Court of Appeals Commonwealth had assumed that the record was complete and had argued on the basis of that record that its claim of rescission was proper and timely. Thus in its brief in the Court of Appeals Commonwealth pointed to facts in the record upon which it based an argument that the alleged fraud was recently discovered and the claim for rescission promptly made.* The Court of Appeals accurately noted in denying the Petition for Rehearing that:

> "... Commonwealth's original brief did not suggest that this issue was not ripe, but contended, quite ineffectually, that the record was adequate" (Appendix B, p. 72).

The Court of Appeals properly refused to receive Commonwealth's tender of proof.

Finally, Commonwealth urges that, if it is not entitled to retry its motion before the District Court, it should be permitted to do so by the submission of affidavits to the Court of Appeals.

It is, of course, clear that the record in a case must be closed sometime and that the submission of new evidence in the Court of Appeals cannot be countenanced.

It is too well settled to require extensive argument that new evidence may not properly be submitted for the first time on appeal. *E.g., Brown* v. *Wilson & Company*, 239 F. 2d 280 (7th Cir. 1956). The impropriety of such a

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*Brief for Plaintiff-Appellee on Consolidated Appeals, pp. 44-45.

tender of proof is even more apparent where it occurs on Petition for Rehearing after the Court of Appeals has already disposed of the case. *Jones v. Zurich Gen. Acc. & Liab. Ins. Company*, 121 F. 2d 761, 764 (2d Cir. 1941).

The only authority cited by Commonwealth in urging the Court of Appeals to accept this new evidence was *Norris v. Alabama*, 294 U. S. 587, 593, note 1 (1935) (R. 42b). That case is completely irrelevant since the Court there merely allowed the production on the argument of certain jury rolls which had been in the record before the lower court.

Commonwealth is not entitled to retry its motion either in the District Court or in the Court of Appeals.

III.

The Court of Appeals properly instructed the District Court to stay further proceedings pending termination of the arbitration.

Finally, passing from its objections to that portion of the decision of the Court of Appeals which set aside the District Court's preliminary injunction, Commonwealth objects to the instruction by the Court of Appeals that the District Court stay its further proceedings pending termination of the arbitration.

Commonwealth first seeks to suggest that there is some inconsistency between this instruction and the determination of the Court of Appeals that the District Court had not abused its discretion in entertaining the motion for stay. Thus Commonwealth argues at length, at pages 17 and 18 of its Petition that the Court of Appeals found no error in the District Court's exercise of its discretion and that the subsequent instruction to the District Court to stay its proceedings was in conflict with this

court's ruling in *Kerotest Mfg. Co. v. C-O-TWO Fire Equipment Co.*, 342 U. S. 180 (1952).

Again Commonwealth confuses two distinct determinations. Applying the rule of the *Kerotest* case, the Court of Appeals found that the District Court had not abused its discretion in entertaining the motion for a stay of arbitration. The Court of Appeals then considered the motion for a stay on its merits and determined that no ground for a stay of arbitration had been shown. The result of this determination was, of course, that the arbitration should be allowed to proceed. The only remaining question was what court should assume jurisdiction with respect to any further judicially cognizable questions which arose in the course of the arbitration. The decision of the Court of Appeals on this question was unquestionably correct.

There has never at any time been any suggestion that, if the arbitration proceeds, the District Court in Puerto Rico should have any jurisdiction to supervise it. Indeed, Lummus argued to the Court of Appeals that, since the parties had agreed that the arbitration would take place in New York, the District Court in Puerto Rico was without jurisdiction even to order the arbitration stayed. *E.g., Marchant v. Mead-Morrison Mfg. Co.*, 352 N. Y. 284, 290 (1929); *Amazon Cotton Mills Co. v. The Duplan Corp.*, 245 N. C. 496, 96 S. E. 2d 267 (1957), *petition for rehearing dismissed*, 246 N. C. 88, 97 S. E. 2d 449. This was one of the questions which the Court of Appeals found it unnecessary to decide. Even if it were assumed that a court has jurisdiction to stay an arbitration which is to take place in another jurisdiction, it would not follow that the Court has power to supervise such an arbitration once it has been determined that the arbitration should be permitted to proceed. The impropriety of such extraterritorial supervision of the arbitration is obvious.

Commonwealth's argument assumes that it has some essential right that the arbitration be governed by the Puerto Rican arbitration statute and supervised by the Puerto Rican Court. This assumption is extraordinary indeed in the face of contracts by which the parties specifically agreed that the arbitration was to take place in New York.

Conclusion.

The decision of the Court of Appeals was based on a thorough analysis of the record in this case and an accurate application of the relevant legal principles. No issue is presented which is appropriate for consideration by this Court. It is submitted that the decision was in all respects correct and the Petition for Certiorari should be denied.

Respectfully submitted,

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